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August 4, 2008

By e-mail to: regs.comments@federalreserve.gov

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

Attn: Docket Number R-1314

Re: Proposed Rule Regarding Credit Card and Overdraft Practices
73 FR 28904 (May 19, 2008)

Dear Ms. Johnson:

This letter is submitted on behalf of The Huntington National Bank ("Huntington Bank")[1] in response to the above-referenced rule proposed by the Board of Governors of the Federal Reserve System (the "Board"), the Office of Thrift Supervision and the National Credit Union Administration with respect to certain practices in connection with credit card programs and overdraft programs. We appreciate the opportunity to provide the comments set forth below with respect to the proposed rule.[2]

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[1] The Huntington National Bank ("Huntington Bank") is a national bank and the principal subsidiary of Huntington Bancshares Incorporated, which is a $55 billion regional bank holding company headquartered in Columbus, Ohio. Along with its affiliated companies, Huntington Bank has more than 142 years of serving the financial needs of its customers, and provides innovative retail and commercial financial products and services through more than 600 regional banking offices in Indiana, Kentucky, Michigan, Ohio, Pennsylvania and West Virginia. Huntington Bank also offers retail and commercial financial services online at huntington.com; through its technologically advanced, 24-hour telephone bank; and through its network of approximately 1400 ATMs. Selected financial service activities are also conducted in other states including: dealer sales activities in Arizona, Florida, Nevada, New Jersey, New York and Tennessee; private financial and capital markets group services in Florida; and mortgage banking offices in Maryland and New Jersey. Huntington Bank's affiliate, Huntington Insurance, Inc., offers retail and commercial insurance agency services in Ohio, Pennsylvania, Michigan, Indiana and West Virginia. International banking services are made available through the headquarters office in Columbus, a limited purpose office located in the Cayman Islands and another office located in Hong Kong.

[2] The Board has also proposed related rules under the Truth in Lending Act and Regulation Z (73 FR 28866 (May 19, 2008)) and the Truth in Savings Act and Regulation DD (73 FR 28739 (May 19, 2008)). The comment period

Our comments on the proposed rule are limited to the overdraft services portion of the proposal, since the remaining portion deals with credit cards and Huntington Bank does not issue its own credit card. We are nonetheless concerned about several portions of the credit card proposal, and we support the comment letters of the American Bankers Association and the Consumer Bankers Association with respect to those concerns.

Turning to the overdraft services portion of the proposed rule, the Board has proposed two substantive rules. First, depository institutions would generally be prohibited from charging overdraft fees on a consumer's account unless the consumer had been provided with notice and an opportunity to opt out of the overdraft service and had not opted out (the "opt-out requirement"). Second, whether or not the consumer has opted out, depository institutions would be prohibited from charging overdraft fees in connection with certain overdrafts resulting from account holds (primarily based on authorizations for debit card point-of-sale transactions) in excess of the actual purchase or transaction amount (the "holds prohibition"). These rules are being proposed on the basis of the Board's authority under section 18(f) of the Federal Trade Commission Act (the "FTC Act"), 15 U.S.C. §57a(f), to prevent unfair or deceptive acts or practices ("UDAP authority").

Our comments on the Board's proposal cover concerns with both the use of the UDAP authority basis for issuing these substantive rules, as well as concerns about the substance of the rules themselves. Generally, UDAP authority is an ill-suited basis on which to make changes or adjustments to mainstream practices—like those here with respect to overdrafts—that have been customary and accepted in the industry, and at least implicitly, if not explicitly, approved by bank regulators, for many years. Additionally, the Board has not established a sufficient evidentiary record, nor has it satisfied the required legal elements, for using its UDAP authority for these overdraft rules. These problems with the Board's use of its UDAP authority can be avoided by proposing any substantive rules regarding overdraft disclosures or practices under the Truth in Savings Act and Regulation DD or the Electronic Funds Transfer Act and Regulation E.

We also have concerns about the substance of the rules themselves. While we do not believe it is necessary or appropriate to single out overdraft fees and subject them to a formal and complex right of opt-out, whether under the Board's UDAP authority or otherwise, we do agree that under current market circumstances there may be less confusion and misunderstanding by consumers if they were more aware that debit card point-of-sale ("POS") authorizations can be approved even if funds are not available in the consumer's account at the time of authorization. We reach this conclusion because it is not currently feasible (for reasons of technology and merchant infrastructure) to be able to offer consumers a per transaction opt-out at the point of sale if funds are not available in the consumer's account when the consumer attempts to use his or her debit card to make a purchase from a merchant. Thus, we are recommending that the Board rework the opt-out requirement into a more targeted solution addressing authorization of

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for both of these related rules closed on July 18, 2008. We incorporate herein the comments submitted in our comment letter in connection with those two related proposed rules.

debit card POS authorizations when the consumer does not have sufficient funds in the account at the time of the authorization. If the Board believes it needs to retain an opt-out requirement, that should at least be limited to opting out of having debit card POS transactions authorized if there is not a sufficient balance in the account at the time of authorization. However, this proposal would apparently be the first time the banking regulators are establishing a formal and complex opt-out requirement for a particular feature of a consumer account, which is not only an overly burdensome and unnecessary solution to the issues this proposal is attempting to address, but will also entangle the Board in product design and pricing issues which are beyond what is appropriate for regulatory action in this case. We believe it is better and more consistent with existing regulation of deposit accounts if any requirement established here is not a formal opt-out requirement, but rather at most a disclosure (i) that authorization of debit card POS transactions can occur even if there are not available funds in the account (depending on the depository institution's practice) and (ii) of what the institution offers either by way of allowing that process to be turned off for the consumer's account or by offering other types of accounts without that feature. We are also concerned that the opt-out requirement as currently proposed is, in addition to being overly burdensome and unnecessary, potentially confusing and misleading to consumers and does not provide sufficient exceptions required by the complexity of the applicable payments systems.

With respect to the holds prohibition our concerns are greater. This proposal is simply unworkable with its predict-the-future feature, which creates significant unwarranted safety and soundness risk and is out of all proportion to the problem it apparently intends to address. We are therefore recommending that the Board withdraw this holds prohibition proposal and replace it with a simple merchant disclosure requirement at the point of sale.

Background

Before turning to our more specific comments on the proposal, we believe it is important to note at the outset of this letter our surprise and concern about several underlying themes coming through the Board's proposal which are inconsistent with past treatment of this subject by the banking regulators and the reality of historic banking practice.

First, the Board is proposing to label as "unfair" the mainstream, historic and customary banking practice of exercising discretion as to whether or not to pay overdrafts. Banks have always exercised that discretion as they deemed warranted for their customers, and the only difference over the past few years is that this process has been automated so as to make it more efficient and to promote consistent treatment of customers. Payment of overdrafts is an important service that benefits consumers and enables a more consistent application of the payments systems and the expectations of the parties making and receiving payments than the disruption and additional cost caused by returned items or denied authorizations. The proposal contains virtually no acknowledgment that payment of overdrafts is a significant benefit to consumers.

Second, the Board's proposal mostly ignores any responsibility on the part of the consumer to keep track of his or her transactions and account balance and the many ways in which depository institutions provide for consumers to be able to do that. Only the consumer knows all of the transactions he or she has performed. The depository institution doesn't know about the transactions until they arrive at the bank in one form or another. Keeping track of transactions is a necessary and essential part of account maintenance in order to avoid overdrafts, and the Board and other banking agencies have stated as much in a brochure (mentioned below) advising consumers how to avoid overdraft fees. Why the Board's view of the consumer's obligation to do that has all of the sudden changed is not understandable. Customer responsibility is clearly part of the process of avoiding overdrafts and related overdraft fees, but the proposal essentially dismisses customer responsibility from the process.

Third, one would gather from reading the proposal that all of the existing disclosures provided by depository institutions (and required by law) with respect to funds availability and overdraft fees are essentially worthless in enabling consumers to avoid overdraft fees, which is at least somewhat ironic in the context of a new and complex proposal for significant additional disclosures. One might also conclude from reading the proposal that the most important thing for consumers to know about their deposit accounts is information about overdraft fees.

Fourth, the Board's proposal does not appear to consider the vast majority of consumers who never go overdraft on their accounts and who benefit from the deposit account pricing they receive as a result of managing their accounts responsibly and appropriately. Instead, the Board's entire focus is on giving additional rights to those very consumers who do not manage their accounts responsibly and the Board appears to ignore the potentially adverse affects the proposal may have on those consumers who do manage their accounts responsibly and never have an overdraft.

These unusual themes clearly color the Board's analysis throughout the proposal and create an unnecessary bias against payment of overdrafts or any notion of consumer responsibility or that consumers already are provided with more than adequate information to manage their accounts and to know what the fees and other rules are about overdrafts. There is quite frankly a certain disregard of how deposit accounts and the related payments systems work that underlies the proposal and prevents it from offering an effective and balanced solution to whatever legitimate consumer misunderstandings and confusions currently need to be addressed.

UDAP Authority Is an Ill-Suited Basis for Issuing These Overdraft Rules

The Board's use of its independent UDAP authority under section 18(f) of the FTC Act in connection with this proposal is the first time the Board has done so in the more than 30 years of the existence of this UDAP authority.[3] As a result, the Board (and the other agencies involved

[3] The only previous exercise by the Board of UDAP authority under the FTC Act was in connection with the issuance of the Board's credit practices rule (Regulation AA) as a follow-up to the Federal Trade Commission's credit practices rule.

in this rulemaking) is exploring new legal ground for applying the standards of unfairness contained in section 5(n) of the FTC Act, 15 U.S.C. §45(n), to banks and other depository institutions. As a legal matter, the standards for unfairness contained in section 5(n) of the FTC Act restrain only the Federal Trade Commission, although the Board states in the proposal that "in proposing rules under section 18(f)(1) of the FTC Act, the Agencies have applied the statutory elements consistent with the standards articulated by the FTC". 73 FR, at 28908, col. 1. These are, of course, those elements expressed in section 5(n). The Board also notes that various banking agencies have issued guidance generally adopting those same standards. 73 FR, at 28908, col. 1 and footnote 11. We agree with the Board that it is appropriate for the Board and the other agencies to comply with these Federal Trade Commission standards of unfairness in connection with any exercise of UDAP authority. However, it is important to note that in the context of the highly supervised banking industry, as distinguished from the generally unsupervised commercial market, there may be other elements that are important to consider, and primary among them in our view are safety and soundness considerations that must be taken into account as part of the balancing that is inherent in the application of UDAP authority by the Board.

In the present case with respect to these proposed overdraft rules, however, the Board's UDAP authority is an ill-suited basis on which to act. Exercise of the Board's UDAP authority should be reserved for acts or practices that clearly deviate from mainstream, customary and historically acceptable norms of business practices and that are egregious or inherently wrong or harmful in some way, rather than be used to correct perceived problems or imperfections or to make routine adjustments or improvements to mainstream historic and accepted business practices. Without such careful restraint, there is no limit to what can be regulated by the Board's UDAP authority or labeled with the scarlet letter of "unfair", rendering superfluous the more specific and targeted regulatory authorities of Regulations E, CC, and DD, which are the foundation of existing payments systems and deposit account and consumer protection requirements. Using UDAP authority that requires joint agency action to cover the same turf as these more specific and targeted regulations is less efficient and presents complicating risks not present under these other regulations. In the present case, banks and other depository institutions have exercised discretion to pay overdrafts without consent or opt-out by the consumer since the dawn of banking, and have charged fees for doing so for a long time. Similarly, depository institutions for many years have placed holds on account availability based on pending items that the institution knows it will be liable for when the item posts or settles. While some adjustment and correction in this process may be needed, there is nothing inherently wrong or unfair about these normal and customary practices or the depository institution reserving discretion in connection therewith.

Several aspects of utilizing UDAP authority—and particularly the unfairness aspect of that authority as is being used here with respect to overdraft practices—make exercise of such authority ill-suited for refining mainstream customary and accepted business practices and a clumsy tool for policy-making. First, the concept of what is "unfair" is notoriously subjective and variable, leaving its exercise open to excess and inconsistency from one regulator to another.

In fact, the standards set forth in section 5(n) of the FTC Act were enacted by Congress specifically to address overzealous use of the unfairness standard in enforcement actions by the Federal Trade Commission in the 1970's.[4] Second, once an act or practice is determined by a regulatory agency to be unfair, that can easily be interpreted to mean that such act or practice did not just become unfair at that instant of the agency's determination, but rather has been unfair, and thus potentially has a retroactive reach going back as far as applicable statutes of limitation will permit. Third, it can be argued that whether or not a determination of unfairness has retroactive effect, it at least becomes effective at the time of determination, meaning that institutions subject to such determination have no time to come into compliance with the new determination. Unfortunately, regulatory changes in connection with banking practices often (as here) involve complex systems changes, training and other implementation requirements that take a significant amount of time to accomplish, and exercise of UDAP authority is not readily suited to recognition of this reality. Fourth, unlike regulating by specific statutes and consumer regulations, regulating by UDAP authority is not a manageable way to establish consistent and uniform rules across all impacted jurisdictions, since enforcement of alleged violations of unfairness standards is usually by private litigation or state attorney general litigation where a federal determination of unfairness becomes an important exhibit for noncompliance, but then the actual standards of what is unfair under the statutes or court precedent of the particular jurisdiction are what determine the outcome of the litigation. The states are not necessarily bound, for example, by the standards of unfairness applicable to the Federal Trade Commission or the Board. Fifth, once a particular practice or fee is determined to be unfair, then there is no reason why any other practice or fee which has similar features would not also be challenged as unfair and thus become a target of potential dispute or litigation.

Thus, there is a real concern that issuing these substantive overdraft rules under UDAP authority will be assumed—whether or not that is actually the Board's intention—to be a determination that the practices regulated are unfair,[5] and that such determination may subject

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[4] See the discussion in *American Financial Services Association v. Federal Trade Commission*, 767 F.2d 957 (C.A.D.C. 1985), at 969-970.

[5] We note that nothing in the actual text of the proposed rule with respect to the opt-out requirement or the holds prohibition actually states that the practices being regulated are determined to be unfair. It is only the heading of proposed §227.32 which uses the "unfair" label. If the Board intends in the actual text of the rule to be proposing a safe harbor from a finding of unfairness, then the proposed rule could be more explicit about that. In the supplementary information to the proposed rule, the Board states that it is using its UDAP authority "to adopt rules prohibiting specific unfair acts or practices with respect to overdraft services", but then the Board goes on to state that "[t]hese proposals should not be construed as a definitive conclusion by the Agencies that a particular act or practice is unfair." 73 FR, at 28929. However, section 18(f)(1) of the FTC Act states that the Board's regulations issued as a result of the Board's independent rulemaking authority under section 18(f) are to include "regulations defining with specificity such unfair or deceptive acts or practices" as well as "containing requirements prescribed for the purpose of preventing such acts or practices". If the Board's overdraft rule merely prevented certain acts or practices without defining with specificity the practices that were deemed to be unfair, the rule would appear to be subject to challenge as not complying with the statutory mandate. See *American Financial Services Association v. Federal Trade Commission*, *supra*, 767 F.2d at 983-984. Thus, it does not appear that the Board can avoid actually specifying the covered acts or practices as unfair if the Board is regulating pursuant to its UDAP authority.

depository institutions to reputation and litigation risk based upon nothing more than mainstream, historic, accepted and customary business practices. This is not the appropriate use of UDAP authority, and thus we urge the Board to issue any new substantive regulation of overdraft practices in the normal and ordinary way under existing consumer protection regulations.[6] As discussed below, use of the Truth in Savings Act and Regulation DD or the Electronic Funds Transfer Act and Regulation E is an alternative that would be more appropriate in this case.

We recognize that the Board has stated in the proposal that the banking agencies have wide latitude to determine a remedy to prevent unfair and deceptive acts or practices as long as that remedy has a reasonable relation to the act or practice being regulated, and thus that the agencies are not required to adopt either the most restrictive or the least restrictive means of preventing the act or practice. 73 FR, at 28909, col. 3. However, while the Board and the agencies may not be required to adopt the least restrictive means, neither do they have unfettered discretion with respect to the remedy to be adopted.[7] Even to the extent the Board has latitude to

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Furthermore, state courts or state regulators are not going to be bound by any expression by the Board that it intends these overdraft substantive rules to have prospective effect only.

[6] If the Board believes it cannot completely abandon its UDAP authority with respect to regulation of overdrafts, we recommend that the Board consider moving the currently proposed substantive rules to Regulation E, and consider whether to limit any UDAP rule on overdrafts to proscribing <u>inappropriate</u> marketing practices. We agree with the Board that continuing to distinguish on the basis of whether an overdraft service is "promoted" or not is no longer a useful distinction and has created barriers to disclosure for depository institutions that do not want to be "promoting" use of discretionary overdrafts. See the Board's Regulation DD proposal, 73 FR 28739, at 28744, col. 2. The Board and the other banking agencies have already addressed best marketing practices in the overdraft guidance issued in 2005, 70 FR 9127 (Feb. 24, 2005), and potentially certain inappropriate marketing practices, such as marketing overdraft protection programs in a manner that encourages routine or intentional overdrafts or does not present alternative overdraft protection options or the consequences of extensively using overdraft services, are more the kind of act or practice that UDAP authority is designed to regulate.

[7] See, for example, *Burlington Truck Lines, Inc. v. U.S.*, 371 U.S. 156 (1962), at 167-168:

> There are no findings and no analysis here to justify the choice made, no indication of the basis on which the Commission exercised its expert discretion. We are not prepared to and the Administrative Procedure Act will not permit us to accept such adjudicatory practice. See *Siegel Co. v. Federal Trade Comm'n*, 327 U.S. 608, 613-614. <u>Expert discretion is the lifeblood of the administrative process, but "unless we make the requirements for administrative action strict and demanding, *expertise*, the strength of modern government, can become a monster which rules with no practical limits on its discretion."</u> *New York v. United States*, 342 U.S. 882, 884 (dissenting opinion). "Congress did not purport to transfer its legislative power to the unbounded discretion of the regulatory body." *Federal Communications Comm'n v. RCA Communications, Inc.*, 346 U.S. 86, 90. The Commission must exercise its discretion under § 207 (a) within the bounds expressed by the standard of "public convenience and necessity." Compare *id.*, at 91. And for the courts to determine whether the agency *has* done so, it must "disclose the basis of its order" and "give clear indication that it has exercised the discretion with which Congress has empowered it." *Phelps Dodge Corp v. Labor Board*, 313 U.S. 177, 197. The agency must make findings that support its decision, and those findings must be supported by substantial evidence. *Interstate Commerce Comm'n v. J-T Transport Co.*, 368 U.S. 81, 93; *United States v. Carolina Carriers Corp.*, 315 U.S. 475, 488-489; *United States v. Chicago, M, St. P. & P. R. Co.*, 294 U.S. 499, 511. <u>Here the Commission made no findings specifically directed to the choice between</u>

determine the most appropriate remedy and is not required as a legal matter to adopt the least restrictive one, it is difficult to understand why the Board and the other banking agencies would not, for policy reasons, take an approach that accomplishes the objectives of regulation in the least burdensome manner. Considerations of regulatory burden and adverse affects are a common factor in agency rulemaking and should not lose their place here even in the context of the exercise of UDAP authority.

The Board Has Not Met Its Obligation to Consider the Unique Nature of the Payments Systems

Section 18(f) of the FTC Act provides that the Board and certain other banking agencies have two bases of authority to issue rules regulating unfair and deceptive acts or practices by depository institutions, namely, (i) an independent requirement to prescribe regulations to carry out the purposes of section 5 of the FTC Act and (ii) whenever the Federal Trade Commission prescribes a rule under section 5, the Board and the other applicable banking agencies are required to prescribe a substantially similar rule with respect to depository institutions, unless the Board (and the other agencies) find that the acts or practices being regulated are not unfair or deceptive with respect to depository institutions or the Board (by itself and not the other applicable banking agencies) "finds that implementation of similar regulations with respect to banks, savings and loan institutions or Federal credit unions would seriously conflict with essential monetary and payments systems policies". Thus, embedded in the statute providing the Board's UDAP authority is an acknowledgment that special considerations are due to the payments system whenever the Board (and the other applicable banking agencies) exercises rulemaking under its UDAP authority.[8]

In the current proposal regulating overdraft services, the Board does not appear to adequately recognize its obligation, when it uses its UDAP authority, to consider the unique

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> <u>two vastly different remedies with vastly different consequences to the carriers and the public.</u> Nor did it articulate any rational connection between the facts found and the choice made. The Commission addressed itself neither to the possible shortcomings of § 204 procedures, to the advantages of certification, nor to the serious objections to the latter. As we shall presently show, these objections are particularly important in the present context and they should have been taken into account.

Emphasis added. Even in the case cited by the Board for its wide latitude in determining a remedy, *American Financial Services Association v. Federal Trade Commission*, *supra*, footnote 4, at 988-989, there was consideration by the Federal Trade Commission of narrower remedies, which were rejected because they failed to address the full range of problems being regulated.

[8] This consideration to be given to the impact on monetary and payments systems policies is technically contained in the part of the rule requiring the Board to issue rules if the Federal Trade Commission has first done so, and not in the part of the rule providing the independent authority of the Board to issue rules under this UDAP authority. However, we do not believe this means that this consideration is not applicable when the Board uses its independent UDAP authority. Presumably, Congress assumed that the Board would apply such considerations when it acted independently and did not need to say so, and explicitly inserted the requirement to do so when the Board was compelled to act because the Federal Trade Commission had acted first as one of the reasons for allowing the Board's rule in that case to diverge from the Federal Trade Commission's rule.

nature of the payments systems that are already heavily regulated and carefully balanced to create operational efficiency, financial soundness and remarkable consumer convenience in the case of debit cards and other forms of payment. As indicated subsequently in this letter, there are sufficient and adequate reasons related to how the applicable payments systems here work for depository institutions to exercise discretion to pay overdrafts without the consumer's consent or opt-out and to place authorization holds that turn out to be in excess of the transaction amount. For example, in connection with debit cards (i) merchants obtain authorizations in order to know that they will be paid in accordance with card association rules (that the card is valid and/or that the amount of the purchase will be covered); (ii) as a result, consumers have the benefit of being able to use their debit card for direct access to their own cash instead of using credit, and without having to carry cash or write checks, particularly where checks are less acceptable at point of sale because they do not provide merchants with an equivalent level of protection; (iii) merchants do not have to deal with the risks of handling cash or checks; and (iv) depository institutions benefit by being able to offer another means of account access to their customers, and as part of that generally bear the most risk of losing funds and thus are compensated for that risk by fees and have other ways of managing the risk through account reviews, using their discretion to allow or prohibit overdrafts, etc. When an arbitrary rule injected into this complex payments system prevents or limits the depository institution's ability to partially cover its risks by fees or essentially forces depository institutions into return instead of overdraft, that has a ripple effect back the other direction on the benefits to consumers and merchants by leaving merchants without sales or having to handle more cash and checks, and leaving consumers with problems generated by denied authorizations (can't get the goods/services) and by returned items (additional fees from merchants, impact on credit rating, potential criminal liability, etc.).

Nothing in the proposal indicates that the Board has given sufficient attention to the ways in which both the opt-out requirement and the holds prohibition "seriously conflict with" the affected payments systems as the Board is required to do in connection with any rule issued under its UDAP authority. Instead, much of the proposal tends toward micromanagement of bank practices and the payments systems applicable here, as well as being a quasi-paternalistic effort that assumes the Board knows better for consumers what is good for them than they do themselves. The Board's proposal also has a strong bias against payment of overdrafts, when in fact it appears that a large percentage of customers would rather have overdrafts paid than returned.[9] Payment of overdrafts is a more consistent result for the applicable payments systems than the more disruptive and costly result when items are returned or authorizations are denied. Furthermore, the approach taken in the proposal may have significant unintended consequences in the form of depository institutions having to eliminate existing benefits customarily provided which they could no longer afford to offer, such as not placing account holds as permitted under Regulation CC or offering deposit accounts with no monthly maintenance fees, as well as surprises for consumers when they learn the real consequences of returned items and denied

[9] The comment letter submitted by the American Bankers Association, dated July 18, 2008, with respect to the Board's Regulation DD proposal stated on page 4 that "according to our recent survey by Ipsos-Reid conducted between July 11th and 13th 2008, of the 20 percent who paid an overdraft fee in the last year, 85 percent said that they were glad the payment was covered."

authorizations as a result of choosing an opt-out that is being promoted by the banking agencies in this proposal as a good option.

The Board Has Not Established a Sufficient Evidentiary Record or Satisfied the Required Legal Elements to Regulate Overdraft Services Under the Board's UDAP Authority

As indicated above, this rulemaking is the first time the Board and the other applicable banking agencies have used their independent authority under section 18(f) of the FTC Act to issue regulations. The only other time the Board has issued regulations under section 18(f) was with respect to the original credit practices rule issued by the Federal Trade Commission where the Board was required to issue a substantially similar regulation applicable to depository institutions. In that case, the Federal Trade Commission adopted the credit practices rule "after a nine-year rulemaking period in which an extensive record was developed and each provision of the Rule painstakingly considered"[10] and the Board was in large part able to rely on the record developed by the Federal Trade Commission. Not so in the present rulemaking with respect to overdraft practices. Here, virtually no evidentiary record has been developed and the rulemaking period appears to be a period of only a few weeks, and in general, the proposed overdraft rules appear to be a somewhat hasty last minute addition to the more extensive rulemaking covering credit card practices. This absence of any meaningful evidentiary record to support the Board's conclusions that it has satisfied the required legal elements of the unfairness aspect of its UDAP authority is a significant deficiency which undermines all of the Board's conclusions that it has satisfied the required legal elements.

The legal analysis to determine whether an act or practice is unfair generally involves the following elements:[11] (i) substantial consumer injury, generally as the result of some form of coercion or defective goods or services; (ii) the injury cannot reasonably be avoided because of absence of meaningful consumer choice or because the seller of the goods or services unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decisionmaking; (iii) the injury is not outweighed by offsetting consumer or competitive benefits, including consideration of the costs and burdens that a remedy would entail; and (iv) the conduct at issue is a violation of public policy established by statute, common law, industry

[10] *American Financial Services Association v. Federal Trade Commission, supra*, at 985.

[11] See generally FTC Policy Statement on Unfairness (Dec. 17, 1980), appended to *International Harvester Co.*, 104 F.T.C. 949, 1070 (1984); http://www.ftc.gov/bcp/policystmt/ad-unfair.htm (referred to herein as the "FTC Policy Statement". The FTC Policy Statement sets forth and explains the standards imposed on the Federal Trade Commission by section 5(n) of the FTC Act, 15 U.S.C. §45(n), which reads as follows: "The Commission shall have no authority under this section or section 18 [15 U.S.C. §57a] to declare unlawful an act or practice on the grounds that such act or practice is unfair unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy considerations may not serve as a primary basis for such determination." The Board has issued guidance adopting these standards applicable to the Federal Trade Commission, as has the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. See footnote 11 of the proposal, 73 FR., at 28908, col. 1.

practice or otherwise. As explained in detail below, the Board's analysis of these elements to uphold the use of the Board's UDAP authority in the proposal for both the opt-out requirement and the holds prohibition is inadequate and flawed in several important respects.

(a) Whether There Is Substantial Consumer Injury

The Board states that the consumer injury in the context of the proposed opt-out requirement is what the Board calls "substantial monetary injury due to the fees assessed in connection with the payment of overdrafts." 73 FR, at 28929, col. 1. In the context of the holds prohibition, the Board simply indicates that the consumer injury is the "overdraft fees resulting from debit hold amounts that exceed the amount of the transaction." 73 FR, at 28931, col. 3. While substantial consumer injury in most cases involves monetary harm, and can be found where small harm is imposed on a large number of consumers, the standards enunciated in the FTC Policy Statement generally indicate that substantial harm results from coercion or from defective goods or services:

> In most cases a substantial injury involves monetary harm, as when sellers coerce consumers into purchasing unwanted goods or services or when consumers buy defective goods or services on credit but are unable to assert against the creditor claims or defenses arising from the transaction. [footnotes omitted]

FTC Policy Statement, p. 3. Presumably this means, for example, charging for a product or service that provides illusory or no benefits, or charging for transactions that a consumer was coerced into performing or did not perform voluntarily—in other words, that there is something <u>unfair</u> about the <u>way</u> in which the monetary liability was incurred by the consumer, not just that monetary liability was incurred.[12] The analysis provided by the Board simply asserts that overdraft fees are incurred and could be substantial. The Board has not provided any evidence or justification that consumers are coerced into paying overdraft fees or are paying a fee without being provided a service having real value in return. It is difficult to see how the Board could provide such evidence or justification. The overdraft service provided is a service having real value in that it pays an item the consumer wants to have paid, and overdraft fees incurred are for transactions within the consumer's control that the consumer voluntarily engages in without any coercion by the depository institution. It is, after all, the consumer who has written the check for an obligation the consumer wants to have paid, or has used his or her debit card to make a purchase the consumer desires to make, and the consumer has done so voluntarily without any coercion or requirement from the depository institution to do so.

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[12] In *American Financial Services Association v. Federal Trade Commission, supra* footnote 4, the Court struggled with this part of the applicable test, but stated that "many, *but not all*, of the Commission's unfairness decisions have involved the kind of overreaching seller conduct pinpointed by petitioners", namely, situations involving deception, coercion or withholding of material information. However, the one decision referred to by the Court as the exception involved a safety issue, "promoting razor blades in a way that risked serious injury to small children". 767 F.2d, at 978-979.

(b) Whether the Injury Is Reasonably Avoidable

The Board continues its analysis of its UDAP authority basis for the proposed opt-out notice requirement by stating that the injury is not reasonably avoidable if consumers are "automatically enrolled" in an overdraft service without having an opportunity to opt out. However, this way of expressing the test ensures that it will be failed every time. What the Board should be considering as reasonably avoidable here is not whether the consumer is "automatically" provided a service or whether the institutions retains discretion (by definition, those are unavoidable), but rather whether or not the consumer can reasonably avoid overdrafting his or her account which would then trigger the service or fee. If the "injury" is the fee, or the way the fee is imposed, then whether or not such "injury" is reasonably avoidable amounts to whether there are reasonable ways the consumer can avoid overdraft fees. We believe it is clear that since there are many ways in which a consumer can avoid overdrafts even if the consumer's account has an "automatic" discretionary overdraft feature, that the potential "injury" of incurring overdraft fees is reasonably avoidable.

In support of its analysis, the Board goes on to state that "consumers often lack sufficient information about key aspects of their account" so that they are unable adequately to track their credits and debits to know what their balance is and that "a consumer cannot know with any degree of certainty when funds from a deposit or a credit for a returned purchase will be made available." 73 FR, at 28929, col. 2. However, these assertions are not consistent with the real world of banking, including all of the account opening and statement disclosures consumers are given under the Truth in Savings Act, the Electronic Funds Transfer Act and the Expedited Funds Availability Act. All of the disclosures required by these laws cannot be of such little utility that consumers "often" lack the information they need in order to know what their balance is or cannot know "with any degree of certainty" when deposits will be made available. If these statements were true, there would be little point in proposing yet another extensive (but apparently useless) disclosure routine with the proposed opt-out requirement. In fact, such statements are also inconsistent with other guidance put out by the Board and the other banking agencies. For example, in the brochure published by the Board and other federal banking agencies entitled "Protecting Yourself from Overdraft and Bounced-Check Fees"[13] consumers are told that "[t]he best way to avoid overdraft and bounced-check fees is to manage your account so you don't overdraw it" and consumers are further instructed to keep track of how much money they have by keeping their check register up-to-date, not forgetting about electronic transactions and automatic bill payments, and by reviewing account statements each month.

Moreover, the Board is certainly aware that, even above and beyond all of the required disclosures, depository institutions today more than ever provide multiple and ample means for consumers to obtain information about their account balances and transactions through detailed account information available online, over the telephone, through text messaging to cell phones,

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[13] On the Board's website at http://www.federalreserve.gov/pubs/bounce/default.htm.

and other means, all of which is driven by the need to provide customer convenience and the most competitive products available.

Thus, for the Board to state that injury is unavoidable because consumers don't have the means and can't be expected to keep track of what they have in their accounts is simply not credible, and to conclude that none of the disclosures and other features provided by depository institutions meet a "reasonably avoidable" test is just plain wrong. Consumers are provided with ample information to enable them to avoid overdrafting their accounts, and therefore any "injury" created by overdrawing the account is reasonably avoidable. The test here is whether the "injury" is "reasonably avoidable", not whether it is absolutely avoidable based on complete knowledge of the consumer's actual available balance at every single point in time.

With respect to the proposed holds prohibition, the Board states that the injury is not reasonably avoidable because consumers are generally unaware of the practice of debit holds, and even if they were made aware of it through better disclosure at the point of sale or otherwise, the consumer cannot know the length of the hold and that a consumer "cannot reasonably be expected to verify whether a hold remains in place before each and every subsequent transaction." 73 FR, at 28932, col. 1. But again this is saying that a consumer cannot reasonably be expected to know what his or her available balance is in the account and has no obligation to find out or keep track. The Board provides no evidence or data supporting its statement that consumers are generally unaware of debit holds. In fact, online or telephone banking transaction history available to most consumers often reflects pending transactions like this that impact a customer's balance, and once consumers start using their debit cards, they soon find out the practical information about how the card works, including holds and how long they stay on the account, delays in posting settled transaction amounts and so forth. Consumers are much more capable and aware of how bank products work than the Board gives them credit for. Not only is information about a consumer's balance and available funds readily and reasonably accessible to the consumer, but (as discussed below) public policy evidenced by bad check laws clearly assumes that consumers are supposed to know what funds they have in their accounts before they perform transactions. Again, the test here is one of reasonableness, not absolute knowledge. There has always been some degree of uncertainty about determining an available account balance at a precise point in time because of the ebb and flow and timing of transactions, but that doesn't mean that the consumer doesn't know transactions he or she has performed. To support this element of the analysis by essentially arguing that the consumer cannot know with absolute precision at every point in time his or her exact account balance is to ignore the proper formulation of this element, which is whether or not the injury is <u>reasonably</u> avoidable, and is also to ignore the significant ways in which the necessary information is readily available from the depository institution, and also ignores that the transactions themselves are within the control and knowledge of the consumer.

Furthermore, the Board provides no evidence or data to indicate whether the frequency of debit holds that exceed the transaction amount is sufficient enough to warrant the remedy proposed. Our own data on debit card authorizations indicate that the types of transactions most likely to generate authorizations more than nominally in excess of the actual transaction amount (such as debit card travel and entertainment transactions at hotels, cruise lines, travel agencies, resorts and car rentals) are less than 1% of all debit card authorizations, and are the types of transactions incurred by consumers of more ample means who can be expected to have available funds in their accounts and would most likely not be put into overdraft by such authorization holds. Additionally, we understand that more general industry data indicates that roughly one-third of debit card transactions authorize for estimated amounts, but virtually all of that is for charges at gas pumps and restaurants, the former of which are undergoing changes pursuant to new procedures being introduced by the card associations that will eliminate most estimates (see further discussion below in this letter) and the latter of which for the most part involve only nominal differences between the authorization and settlement amounts that only rarely are the cause of overdrafts. Moreover, the Board has not provided any evidence or data that indicates to what extent depository institutions actually hold funds based on these types of transactions. Our current policy, for example, is not to hold authorizations for travel and entertainment transactions (*i.e.*, transactions at hotels, cruise lines, travel agencies, resorts and car rentals) against the consumer's available balance as a risk decision that we take for purposes of customer convenience, and we understand that many depository institutions have similar policies.

The Board's analysis also gives no consideration to the underlying reasons why authorization amounts can exceed transaction amounts, and by failing to do so implies that this is some kind of overreaching practice by depository institutions for no good reason. As discussed in more detail below, there are many reasons why overdrafts can occur that are beyond the depository institution's control and are built into the nature of the applicable payments systems. And it is these payments systems which provide the remarkable convenience to consumers of being able to use debit cards in the first place, instead of having to carry cash or write checks.

The test here again is one of reasonableness, not absolute information available all of the time. The Board has failed to give adequate consideration to the relative infrequency of excess authorization debit holds that actually cause overdrafts, or to the reasons that they occur, and thus cannot make an appropriate determination as to whether or not authorization debit holds are reasonably avoidable by the consumer in return for obtaining the convenience of being able to access funds through debit cards.

(c) Whether the Benefits to Consumers or Competition Outweigh the Injury

The third element in the Board's analysis of its UDAP authority with respect to the opt-out requirement is the Board's conclusion that the benefits to consumers and competition from not providing opt-out "do not appear to outweigh the injury." 73 FR, at 28929. The Board reaches this (somewhat tentative) conclusion primarily for automated teller machines ("ATM") and POS transactions where the Board states that without the overdraft service the transactions would simply be denied and the consumer would be given the opportunity to provide other forms of payment without incurring any fees. To support this conclusion, the Board cites to a single survey by a consumer group alleging that most respondents to the survey preferred that their debit card be declined at the checkout rather than having the overdraft paid and being charged a fee.

It seems doubtful that one survey reaching what has to be at least a questionable conclusion as a general matter is sufficient to support the Board's finding here.[14] In any case, the Board's assumption that the consumer whose debit card is denied authorization would be given the opportunity to provide other forms of payment assumes that the consumer has other forms of payment and that the merchant would accept them. The merchant most likely would not accept a check from a consumer written on the account which has just been the source of the denial of the debit card authorization. And perhaps the consumer doesn't have credit cards or didn't bring them or doesn't want to use them or has no further availability on any credit cards and for safety or other reasons doesn't carry cash or can't leave the groceries piled on the check-out counter while he or she runs out to the ATM to get cash, which cash in any case would not be available even at the ATM from that account that generated the debit card denial if going overdraft is not an option. Moreover, the Board's statement that authorization denials do not incur fees may generally be the case in the current market, but may not always be that way, particularly if the current proposal forces depository institutions to find other ways of covering risk, including charging consumers for authorization denials which do have a cost to the institution. The Board's summary dismissal of the benefits that consumers are provided when the depository institution authorizes the debit card or ATM transactions is not appropriate under the overall balancing of injury versus benefit that is at the heart of the correct legal analysis to apply here.

But the Board goes beyond this to conclude that even in the case of check and ACH transactions the injury is not outweighed by the benefits—even though the consumer would be charged a returned item fee equal to what the overdraft fee would have been, and could incur additional liability to the merchant for bad check fees and/or late fees, as well as suffer impairment to the consumer's credit rating, and potentially even be subject to criminal liability for writing bad checks. The Board's only stated reason is that the consumer may prefer instead to have the item returned to avoid additional daily overdraft fees (assuming the depository institution imposes such daily overdraft fees). Of course a consumer may prefer that, but that preference by some (and certainly not all) consumers, and probably not even the same consumer all of the time, does not warrant the Board's summary dismissal of countervailing benefits to consumers in the context of a test which requires a balancing of injury versus benefit. Particularly with check and ACH transactions the costs of returning an item will, even with potential daily overdraft fees, almost always exceed the cost of paying the item as well as involve other significant detriments to the consumer, such as adverse credit rating,

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[14] How consumers respond to questions about denial of authorization at check-out depends on how such questions are asked or what the context might be. Being declined at the coffee shop for that extra cup of coffee is one thing. One can easily think of contexts where one would expect the consumer's response to be different, such as the parent making an emergency run to the grocery store to buy baby formula and being declined, or the consumer who has waited through a long check-out line with a cart full of groceries and hungry children in tow only to be declined. Also, see the reference in footnote 9 above to the study commissioned by the American Bankers Association, which indicates that a majority of customers appreciated having their overdrafts paid.

embarrassment at the point of sale, and even potential criminal liability. There is simply no way any proper UDAP analysis can conclude in the case of check and ACH transactions that the benefits of paying overdrafts do not outweigh the "injury".

Additionally, the Board does not address the second part of the benefit side of the analysis, namely, the benefits to competition in general of not providing an opt-out from the depository institution's discretionary payment of overdrafts. Apparently the Board has done no study of the potential impact that exercise of a widely provided opt-out by a large number of depository institution customers would have on the payments system, on merchants whose goods and services would not be purchased, on depository institutions who would now have to find other ways to cover increased risk, and on consumers in general who may end up with fewer banking options or more costlier banking products or fewer forms of payment if opt-out exercise by consumers results in merchants refusing to accept debit cards or makes it too costly or impractical for depository institutions to offer them as widely as they are offered today.[15]

With respect to the proposed holds prohibition, the Board concludes that the injury is not outweighed by countervailing benefits because as long as the consumer has not opted out, the depository institution is able to charge an overdraft fee on that debit card transaction if it later settles into overdraft. Apparently, the holds prohibition is not intended to prevent charging an overdraft fee at the time of settlement of the previously authorized debit card transaction if there are insufficient funds at the time of settlement to cover <u>that</u> debit card transaction. Rather, the prohibition apparently is against charging overdraft fees on <u>other</u> transactions posting against the account between the time of authorization and settlement of that debit card transaction if the excess portion of the authorization hold is the reason for those other transactions going overdraft. The Board's analysis here is apparently that the injury suffered by the consumer in the absence of the holds prohibition is not outweighed by countervailing benefits because the depository institution is adequately compensated for its potential loss by being able to charge an overdraft fee on the debit card transaction if it later settles into overdraft. But the Board is applying an "apples and oranges" comparison. The injury to the consumer being addressed here is being liable for overdraft fees on <u>other</u> transactions that the excess hold amount on that debit card transaction forces into overdraft, and the countervailing benefit to the consumer would

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[15] The Board also expresses concern about circumstances where the amount of the overdraft fee "may substantially exceed" the amount of the overdraft. 73 FR, at 28929, col. 2. We recognize how this can appear to be a concern, but believe there are several reasons why this concern has less weight in the legal analysis than the Board appears to give to it. We note first that many such small dollar items that cause overdrafts are for discretionary items (like the proverbial cup of coffee at the coffee shop) that consumers can easily control or avoid, rather than the mortgage payment or the car payment for which the consumer has little or no discretion. Moreover, many small dollar overdrafts are incurred not by consumers of less means who have low balances, but by consumers of sufficient or ample means who manage their accounts to keep checking account balances as low as possible so that their funds can earn more elsewhere and end up in overdraft because of playing it too close or miscalculation. In any case, overdraft fees for small dollar transactions that overdraw the account are relatively easy for consumers to avoid precisely because they are small dollar transactions that would have been covered if the consumer had left just a little bit more money in the account. All of this indicates that small dollar transactions are less significant than might at first appear in the balancing scale that is required to be employed in this element of the legal analysis.

presumably be the ability to perform debit card transactions which might go away if the depository institution cannot cover its risk. However, the risk the Board is indicating is being covered is not the risk associated with the other transactions that go overdraft, but rather the risk associated with the triggering debit card transaction going overdraft. The fact that the Board's holds prohibition still permits the depository institution to charge an overdraft fee on the debit card transaction if it settles into overdraft does not alleviate the actual prohibition here—which is against charging an overdraft fee on the other transactions. Since, under the predict-the-future nature of the holds prohibition the depository institution will not know if it can charge an overdraft fee on the other intervening transactions that go overdraft as a result of the authorization hold amount, the depository institution will effectively be required either to stop charging overdraft fees on all overdrafts occurring whenever there is a pending transaction hold on the account (since the depository institution will not know which ones it can charge on and which ones it can't until too late) or stop placing authorization holds (since for various reasons the depository institution can never be sure that an authorization amount will not exceed the transaction amount).[16] Nothing about the holds prohibition compensates the depository institution for those risks. This may well lead to a conclusion by the depository institution to restrict or limit its issuance of debit cards or to take other steps to reduce risk, meaning therefore that there is in fact a countervailing benefit by the depository institution not taking such steps in the absence of the holds prohibition.

Moreover, the Board's analysis here is only applicable if the consumer has not opted out, and presumably the Board anticipates that many consumers will opt out or the Board would not be going through the exercise of proposing this rule. For those consumers who do opt out, there will be many reasons (as further discussed below) why the depository institution will be required to pay or debit intervening items/transactions that will cause the debit card transaction to overdraw when it settles, and because the consumer has opted out, the depository institution will not be able to charge the overdraft fee on that settling debit card transaction. Since it is this overdraft fee that the Board incorrectly believes provides the protection to the depository institution which compensates for the holds prohibition, even this compensation would not be available for the accounts of all those consumers who have opted out.

But even in the case of those consumers who have not opted out, the Board only addresses the protection to the depository institution that the overdraft fee it can charge in this situation provides, and does not address the benefits to consumers and to competition in general even in the context of an authorization hold that turns out to be higher than the actual transaction amount. As indicated above in connection with the second element in the legal analysis, the Board's analysis here gives no consideration to the underlying reasons why authorization amounts can exceed transaction amounts that are beyond the depository institution's control and are built into the structure of the applicable payments systems, and it is these payments systems which provide the remarkable convenience to consumers of being able to use debit cards in the first place, instead of having to carry cash or write checks which many merchants will not accept.

[16] See discussion of this point below. Under the proposed holds prohibition, the depository institution will not be in compliance if it complies only most of the time.

(d) Whether Public Policy Supports Imposition of the Rule

The fourth element of the legal analysis supporting the Board's UDAP authority with respect to the proposed rule is not separately addressed by the Board. The FTC Policy Statement indicates that this public policy factor is used "to test the validity and strength of the evidence of consumer injury" (p. 4).[17]

We note that public policy with respect to overdrafts on checking accounts is contained in a number of laws, most notably the laws of most states that penalize, and in some cases criminalize, the writing of bad checks. Additionally, Uniform Commercial Code §4-303(b) provides that "items may be accepted, paid, certified, or charged to the indicated account of its customer in any order" and Official Comment 7 under this section indicates further that since "[t]he drawer has drawn all the checks, the drawer should have funds available to meet all of them and has no basis for urging one should be paid before another." There is thus ample indication of public policy supporting a consumer's responsibility to manage properly his or her bank accounts to avoid creating overdrafts. Such public policy weighs against the Board's conclusion that consumers are injured by not having a choice to prevent the depository institution from exercising discretion to pay overdraft items without the consumer's consent, since in general creating items that overdraw an account and are returned unpaid is against these expressions of public policy, and a depository institution's exercise of discretion to pay overdrafts allows the items to be paid instead of returned and is thus consistent with such expressions of public policy. The Board's summary dismissal of consumer responsibility expressed in such public policy and the consistency of depository institution payment of overdrafts with such public policy improperly ignores this component of a proper legal analysis and weakens even further the Board's conclusion that there is substantial consumer injury.

The Board Has Authority Under Other Laws to Regulate Overdraft Services

To the extent that substantive rules are required to addresses issues that have arisen with consumer choice or account holds in connection with overdraft services, the Board can provide disclosure rules under the Truth in Savings Act ("TISA") and the Board's Regulation DD. Other substantive regulation could be provided under the Electronic Funds Transfer Act (the "EFTA") and the Board's Regulation E, since the issues the Board apparently believes need to be addressed are primarily—if not exclusively—related to electronic fund transfers and because the Board's EFTA authority extends beyond depository institutions to include other parties (such as merchants) who can be part of any solution.

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[17] Section 5(n) of the FTC Act indicates that this public policy element may not serve as a primary basis for the unfairness determination, but that limitation was imposed because the public policy element is usually drawn on to support a finding of unfairness, whereas in this case, the public policy element weighs against a finding of unfairness.

If the Board adopts our recommendation below to replace the opt-out requirement with a disclosure of options available to the consumer in connection with debit card POS transaction authorizations or overdrafts in general, such disclosure requirements could be provided pursuant to the Board's authority under TISA and Regulation DD. To the extent disclosures by merchants at the point of sale would be a solution, it appears that EFTA and Regulation E provide the necessary authority. If some form of opt-out requirement is retained (for example, a right to opt out of debit card POS transaction authorizations when the consumer does not have funds available at the time of authorization), it appears again that EFTA and Regulation E provide the necessary authority.

Section 902(b) of the EFTA provides that "[i]t is the purpose of this title to provide a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund transfer systems." Section 904(a) of the EFTA requires the Board to prescribe regulations to carry out the purposes of the EFTA, and when it does so to, among other things, "prepare an analysis of economic impact which considers the cost and benefits to financial institutions, consumers, and other users of electronic fund transfers". Section 904(d) of the EFTA requires the Board to require by regulation that the disclosures, protections, responsibilities, and remedies of the EFTA are also made applicable to persons who are not the account holding institution that make electronic fund transfer services available to consumers. Section 205.3(b)(2)(ii) of Regulation E, for example, extends the coverage of Regulation E to merchants who initiate electronic fund transfers using a consumer's check as a source of information (conversion of checks to ACH transactions). Thus, the EFTA clearly reaches overdraft services that are electronic fund transfer services, and reaches a range of participants beyond just the account-holding depository institution in connection with such services.

Furthermore, the Board's primary concerns with respect to the overdraft services it is proposing to regulate appear to be with such services provided in connection with debit card POS and ATM transactions, rather than with paper transactions such as checks which generally are not regulated by the EFTA.[18] For example: (i) the Board asks for comment as to whether the proposed opt-out right should be limited to ATM transactions and debit card POS transactions (73 FR, at 28931, col. 2); (ii) the Board's legal analysis for its UDAP authority recognizes that check and ACH transactions, as distinguished from ATM and debit card transactions, generally incur similar fees whether or not the item is paid or returned (73 FR, at 28929, col. 2); and (iii) the Board notes that the disparity between the overdraft fee amount and the amount of the transaction that overdraws the account is more prominent in the case of POS debit cards (73 FR, at 28929, col. 2). Thus, using the EFTA as the basis for regulatory authority and limiting the

[18] However, a check deposit at an ATM is included in the definition of an "electronic fund transfer". See the Board's Official Staff Commentary under Regulation E, Comment 3(b)(1)-1.i. Thus, checks are not completely outside of the scope of Regulation E.

proposal to overdraft services in connection with electronic fund transfers would appear to be within the primary scope of what the Board is intending to regulate with this proposal.[19]

Issuing any overdraft disclosure rules under Regulation DD or substantive overdraft rules under Regulation E would also fulfill a primary mandate that the Board would be fulfilling by the exercise of any UDAP authority, namely, prescribing "regulations . . . containing requirements prescribed for the purpose of preventing such [*i.e.*, unfair or deceptive] acts or practices." FTC Act, §18(f)(1). In other words, by utilizing Regulation DD or Regulation E the Board would still be carrying out an important mandate of FTC Act §18(f) without actually having to use the UDAP authority granted by that Act and without having to make any determination that any particular act or practice is "unfair".

Issues with the Substance of the Board's Proposed Opt-Out Requirement

(a) Calling the Opt-Out Right the Right to Opt Out of Overdrafts Is Potentially Confusing and Misleading to Consumers

The Board's proposed opt-out requirement is phrased as providing "the consumer with the right to opt out of the bank's payment of overdrafts". Proposed §227.32(a)(1). Similarly, the proposed model form of opt-out notice says that "[y]ou have the right to opt out of this service and tell us not to pay any overdrafts" and "this service" means "that if there is a debit to your account when your account does not have sufficient funds, we may pay your overdraft."[20] Thus, what the Board appears to be saying is that the consumer must be given the right to opt out of the payment of overdrafts. However, the term "overdraft service" is defined as a service where the depository institution charges a fee for paying items that overdraw an account, so that opting out of an overdraft service presumably is intended to mean opting out of having to pay any fee for the depository institution paying items that overdraw the account, rather than opting out of having the depository institution pay any overdrafts.[21]

The wording of the Board's proposal is thus potentially confusing and misleading to consumers when it appears to indicate that the consumer has the right to tell the depository institution not to pay any overdrafts, when in fact the consumer is only given the right to tell the

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[19] As a practical matter, if a depository institution is only able to offer opt-out on an all or nothing basis—and we understand that many institutions are currently in this situation—then mandating an opt-out of overdrafts for certain electronic fund transfers will have the effect of including checks as well for such institutions.

[20] The form of opt-out notice is included as part of the Regulation DD proposal in connection with overdraft services, and is not included in the Board's substantive rule issued under its UDAP authority. See 73 FR 28739, at 28749.

[21] See 73 FR., at 28930: "Under the proposal, if the institution does pay an overdraft, the consumer's decision to opt out of the institution's overdraft service would not prohibit institutions from paying overdrafts in all cases. Rather, if the institution does pay an overdraft, the consumer's decision to opt out would generally prohibit the institution from assessing a fee for the service."

depository institution not to charge for the payment of overdrafts.[22] One might ask why that distinction matters, since presumably consumers don't really care if the depository institution continues to pay overdrafts—and may in fact like that—as long as the depository institution doesn't charge for doing so. The problem, however, is that (as indicated in more detail below) depository institutions are not going to be able to stop paying all items or other debits that overdraw an account, and yet the Board's rule appears to indicate that it is requiring depository institutions to do just that and to disclose to consumers that it is doing just that. There are potentially situations where consumers may believe, since they have "opted out of overdrafts", that an item will not be paid if it overdraws an account, when in fact the item is paid by the depository institution, and the consumer may then allege that the depository institution misrepresented what it would do with the item. More generally, consumers who have opted out, but continue to see items paid that overdraw the account, may well think that the depository institution is not complying with the law and that, in some way that the consumer can't quite understand, the institution is harming the consumer by not doing what the law apparently requires the depository institution to do. This way of phrasing the rule and the consumer notice at a minimum creates difficult customer service issues that put the depository institution in the position of trying to explain why what looks like a violation of the rule really isn't one, and that kind of conversation with a customer starts on the wrong foot and stays on the wrong foot in trying to establish in general that the depository institution is the kind of institution that does the right thing and complies with the law.

(b) The Partial Opt-Out Right Is Potentially Confusing and Misleading to Consumers and a Significant Burden to Depository Institutions

The Board's opt-out proposal includes a requirement to provide a consumer "the option of opting out only for the payment of overdrafts at automated teller machines and for point-of-sale transactions initiated by a debit card, in addition to the choice of opting out of the payment of overdrafts for all transactions."[23] Proposed §227.32(a)(2). Unless the Board is requiring depository institutions to pay checks, ACH debits and items other than ATM and POS debit card transactions, this option for the consumer to partially opt out is illusory.

Payment of overdrafts by the depository institution is discretionary on the part of the institution, and we do not believe that anything in the proposed rule for overdraft services is intended to change that or otherwise require depository institutions to pay items and other transactions that overdraw an account if the institution elects not to do so. Therefore, if the consumer elects this partial opt-out and tells the depository institution not to pay ATM or POS

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[22] We also recognize that being able to express what the Board is attempting to provide with this opt-out requirement is inherently difficult, since it involves a combination of opting out of overdrafts and paying for such opt out which is a difficult concept to convey to consumers (or even bank employees). This is yet another reason for the Board to consider other alternatives.

[23] This language has the same problem discussed in the section of this letter immediately above by appearing to grant a right to opt out of the overdrafts, rather than opting out of paying for them.

debit card transactions that overdraw the account, there is nothing (unless this rule creates it) prohibiting the institution from also exercising its discretion not to pay other kinds of overdrafts. The end result of this (apparently) illusory offer will be that the consumer elects to opt out only of ATM and POS debit card overdrafts, but finds that the depository institution is also not paying other kinds of overdrafts, and it immediately looks like the depository institution is somehow violating the rule. The rule is presumed to mean something when it gives consumers the right to a partial opt out, and therefore a consumer may easily believe he or she is being treated improperly under the rule if the depository institution also doesn't pay check and ACH overdrafts. At the least, as with the apparent right to "opt out of overdrafts" discussed above, the Board is creating a difficult customer service problem for the depository institution by putting the institution in the position of trying to explain to its customers how not doing what the rule appears to be saying is really complying with the rule. Consumers will become suspicious and will conclude that something is just wrong, and then the customer relationship is impaired.

Of more concern is that this partial opt-out right does not have to be interpreted quite so far as to require a depository institution to pay other kinds of overdrafts. Notwithstanding what the proposed rule says, it is difficult to believe that a court or consumer would really expect it to be taken to the extreme and allow a consumer to write bad checks all day and expect the depository institution to have to pay them.[24] Rather, a more refined interpretation could be that the existence of the right of partial opt-out at least means that the depository institution has some good faith obligation to offer the partially opting-out consumer the "service" of paying checks and ACH overdrafts (and of course, getting an overdraft fee for doing so), at least as long as the consumer would reasonably qualify for such "service" under some general expectation of what kinds of consumers should be eligible therefor. It is not inconceivable that consumers would at least expect that much or that their lawyers would make such arguments in court or that courts would accept such arguments, because after all, there is that presumptive rule of construction that this partial opt-out right set forth in a regulation from a federal banking agency must mean something.

There are also other practical issues with the partial opt-out requirement. Many (if not most) depository institutions have no current way in their applicable systems to offer the kind of partial opt-out that the Board is requiring. Apparently, most depository institutions can only opt the consumer out of all discretionary overdrafts, and cannot do so for particular types of transactions and not others. Additionally, the discretionary overdraft feature is normally turned off by setting the automated amount of daily discretionary overdraft availability on a particular account to zero, which would have the effect of preventing discretionary overdrafts, but would not prohibit overdrafts that force post to the account. Unless the institution also has a way in its system not to charge overdraft fees for that account for those non-discretionary overdrafts, there will be additional complications with implementing any partial overdraft right. The Board generally dismisses these operational and system complications with the statement that "the benefits of providing consumers a choice regarding the transaction types for which they want to

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[24] Although even that could be the conclusion of some court somewhere based on the notion that the depository institution is at least getting paid an overdraft fee to compensate for the risks of having to pay such items.

have overdrafts paid outweighs the potential programming costs associated with this requirement." 73 FR, at 28930, col. 2. However, where this choice is illusory it hardly outweighs programming costs, and even where the choice is interpreted to have some meaning to it, programming costs to implement, plus additional risks of being expected to pay at least some other types of overdrafts, are of significant weight in the balancing analysis the Board should be performing here.

Furthermore, if with respect to the exercise by the consumer of the partial opt-out right for debit card POS and ATM transactions the depository institution is somehow required to pay checks that overdraw the account, the bank will not be permitted to charge an overdraft fee for debit card transactions that overdraw the account as a result of paying such checks unless the actual amount of the debit card transaction is larger than the authorization amount.[25] This is just one example of the lack of sufficient exceptions from the opt-out requirement that are more fully discussed below.

Yet another issue with the partial opt-out requirement is what types of transactions the Board actually intends to be included within the right of partial opt-out. Literally, §227.32(a)(2) states that the partial opt-out applies to the payment of overdrafts "at automated teller machines and for point-of-sale transactions initiated by debit card". Thus, the right to partial opt-out would apparently not apply to use of debit cards to pay bills in recurring payment situations (as when the consumer provides his or her debit card number for a merchant or vendor to use to make recurring mortgage or health club payments). Additionally, some consumers have ATM cards that can access ATMs but are not debit cards that can be used for POS transactions, or at least that can only be used for POS transactions that are PIN transactions, rather than signature transactions. The Board's proposed partial opt-out at ATMs appears to be for any type of card usable at an ATM, and not just what the depository institution would normally consider a debit card. Depository institutions may not have the current system capability to exclude some types of debit card transactions from (the recurring payment transactions, for example), or to include some types of non-debit card transactions (such as ATM cards that are not debit cards) in, this right of partial opt-out.

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[25] Consider the following example:

Day 1	$1,000
$75 debit card authorization memo-post	$925
$200 check	$725
Day 2	$800 (prior day memo-post falls off at start of day)
$75 debit card authorization memo-post	$725 (debit card authorization still outstanding)
$700 check	$25
$100 check	<$75> (triggers overdraft fee)
Day 3	$0 (prior day memo-post falls off at start of day)
$30 OD fee	<$30>
$75 DC settles	<$105> (can't charge overdraft fee)

The bank is prohibited from charging the overdraft fee when the $75 debit card transaction settles because the consumer has partially opted out for debit card POS and ATM transactions and the opt-out exception for transactions that settle for amounts larger than authorized is not applicable since in this example both the authorization and settlement of the debit card transaction was for $75.

(c) The Opt-Out Requirement Creates Undue Safety and Soundness Risk by Not Creating Adequate Exemptions

The Board's opt-out requirement contains only two narrow exceptions with respect to debit card transactions[26] under which a depository institution may still charge an overdraft fee even though the consumer has opted out. These are (i) when there were sufficient funds in the account at the time of authorization of the debit card transaction, but the actual purchase amount exceeds the authorization amount and (ii) where the debit card transaction is paper-based and the depository institution had not previously authorized the transaction. Proposed §227.32(a)(3).

Taking the second exception first, this one would appear to be a very limited exception indeed, since it would only apply where a debit card transaction is sent out for settlement by the merchant by taking the paper card imprint sales slip to its depository institution for deposit. It is our understanding that only a very small minority of debit card transactions continue to be processed in this way. It is important to understand that this is not an exception for debit card transactions that are not authorized, but rather an exception for debit card transactions where the transaction is not authorized and the merchant deposits the paper card imprint sales slip at the merchant's bank.

Looking then at the first exception, this appears to recognize that when depository institutions authorize debit card transactions, they are then committed under card association rules to pay the transaction when it later comes in for settlement, regardless of whether or not there are sufficient funds in the account at the time of settlement, and notwithstanding that the consumer has "opted out of the payment of overdrafts". Typically, signature debit card transactions take three to five days to settle after the date of the transaction (which would also generally be the date of the authorization), whereas PIN debit card transactions typically settle on the same day as the transaction (and thus also on the same day as the authorization). Thus the Board is rightly providing an exception from the prohibition against charging an overdraft fee even though the consumer has opted out in this situation where the depository institution is required to pay debit card transactions that settle for an amount larger than the authorization amount. The assumption appears to be that the depository institution can provide a hold based on the authorization amount, and thus as long as the transaction settles a few days later for an amount not greater than the authorization amount, the depository institution would have the funds and the debit card transaction would not overdraw the account, because there would also

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[26] Literally under proposed §227.32(a)(3) the exception is for "a debit card transaction", and it is not clear what the Board really means to include in the term "debit card transaction". For example, is this intended to include ATM transactions when a debit card is used at the ATM? Sub-paragraph (a)(3)(i) refers to "purchase amount" which appears to suggest POS transactions only, but then sometimes purchases can be made at ATMs (for postage stamps or public transit tickets). Sub-paragraph (a)(3)(ii) covers certain paper transactions, which would appear to exclude ATM transactions, since ATM transactions are electronic and are not presented by a "paper-based means". Also, as indicated above, debit cards can also be used in transactions that are not POS transactions.

not be any other intervening items that had overdrawn the account since the consumer has opted out of the payment of overdrafts.[27]

However, there are in fact many kinds of situations where, notwithstanding the consumer's opt-out, the depository institution would be required to pay or debit items or other transactions that overdraw the account, which could then result in the debit card transaction overdrawing the account when it settles and the depository institution is prohibited from charging an overdraft fee. In addition to the example discussed above in connection with footnote 25 in the context of a partial opt-out, examples of these kinds of situations are as follows:

- Authorizations of PIN-based POS debit card transactions are generally not held against the account's available balance and many are for a minimal amount ($1) intended only to verify that the card is valid. An authorization is provided at the time of initial inquiry by the merchant, which is typically when the transaction is being paid for by the consumer. During the time between that authorization and an update that provides the actual amount for such a transaction ("transaction 1"), other POS or ATM transactions could be approved into seemingly good funds and receive authorization from the depository institution. All of these other transactions would be authorized by the depository institution, but because they are not able to take transaction 1 into consideration (no hold for transaction 1), could result in the account being overdrawn when these other transactions are later presented for settlement.

- Authorization amounts are typically only held against an account by the depository institution for a limited number of days (3 days, for example). When settlement of the transaction ("transaction 1") is delayed past that time (because of some delay in the settlement process or because the merchant delays sending the transaction out for settlement or batches settlements every few days instead of every day), those funds will become available again on the account. When this occurs, the depository institution may authorize other POS or ATM transactions on seemingly good funds but then have to settle those other transactions into overdraft when transaction 1 is presented for payment, or transaction 1 could itself settle into overdraft.

- Debit card transactions originated in foreign countries are authorized based on the current exchange rate. When the foreign transaction is actually settled some days later, such settlement is at the exchange rate on the settlement date. When the dollar is falling, settlement will be greater than the authorization and could result in overdraft. In this case, the existing proposed exception to the proposed opt-out requirement would allow depository institutions to assess an overdraft fee for this

[27] We note that this same reasoning would compel an exception for debit card transactions that were never authorized, because similarly the depository institution does not know that this transaction is coming and thus cannot protect for it with a hold, just like the institution cannot protect for an amount that settles for higher than the amount authorized. It is thus not clear why the Board has not provided this exception as well.

foreign transaction because the amount of settlement is larger than the amount of the authorization, but in any case where the currency exchange rates went in the other direction and the actual transaction amount settled for less than the authorization amount, the Board's proposed exception would not be available and the depository institution would not be able to charge an overdraft fee on the foreign transaction if, because of other intervening items, the foreign transaction overdraws the account at time of settlement. (Additionally, in the latter situation, under the holds prohibition the depository institution would not be permitted to charge overdraft fees on any intervening items that overdraw the account because of what turns out to be an excess hold amount on the foreign debit card transaction.)

- When there are problems with network connectivity, debit card processors operate in "stand-in" mode. Based on the card's BIN (e.g., Gold Card, Platinum Card), a card may have varying authorization limits. Currently, depository institutions are compensated for the risks associated with allowing "stand-in" authorizations by being able to charge overdraft fees. If depository institutions are unable to assess overdraft fees (because the consumer has opted out) when the institution authorizes stand-in transactions during these time periods, the institutions may determine no longer to offer stand-in approvals for some or all consumers who may today get the benefit of such stand-in approvals.

- A more general problem will be caused because all debit card transactions are force-post items, meaning the depository institution must post the item when it settles regardless of the available balance at that time. We (and presumably other depository institutions as well) currently do not have the ability to evaluate whether a transaction was authorized or not during posting, and usually the only time a merchant is charged back for a debit card transaction is when the consumer complains that the transaction is unauthorized. Unauthorized transactions are processed on an exception basis and are handled manually. Thus, even though the proposed regulation provides an exception for debit card transactions "settled by paper means" that are not authorized, we do not currently have an automated way within our posting process to recognize that the transaction was not authorized. Additionally, even though it would be in the depository institution's interest to return those items which were required to be authorized by card association rules, but were not, we do not have a system-wide process to automatically return these items. It is likely that development would be required by the debit card processors (i.e., FDR, Visa, Plus) and by depository institutions' posting programs to be able to recognize those transactions as different from other debit card transactions and create a process to automatically return them.

- Problems may be encountered with overdraft protection funded from another deposit account. At approximately 10:00 p.m., Huntington Bank runs a collection job to determine the funds that are available from deposit-to-deposit funding accounts. The balance collected on savings and money market deposit funding accounts include outstanding authorizations made up to that time. The bank does not have any way of knowing what funds (if any) will be needed to cover presented items on the checking account, so no holds are placed on the funding account. When funds are then needed by the checking account from the funding account during overnight posting, we generate a transfer deposit that is posted to the checking account in the current cycle, and a transfer withdrawal that is memo-posted to the funding account the following morning and hard posted in the next cycle. From approximately 10:00 p.m. when we run this collection to the time that a memo-post can be applied to the funding account, we could authorize ATM or debit card transactions that will ultimately post into overdraft on the funding account.

- If a consumer disputes a debit card transaction as unauthorized, for example, the depository institution is required to provide provisional credit for the disputed item. Once investigated, the disputed transaction may be debited back from the account. This is another scenario that is not accommodated in the two exceptions to opt-out that allow a depository institution to charge an overdraft fee, because the institution could authorize debit card transactions on seemingly good funds, when those transactions would actually post into overdraft when settled because of the debit of the provisional credit.

- If a previously deposited item is returned between authorization and settlement of a debit card transaction, that debit card transaction could settle into overdraft because of the intervening debit of the returned deposited item. Another similar example would be adjustment debit transactions that are posted due to encoding errors or other error conditions.

- Posting of depository institution fees are another reason why authorized debit transactions could eventually settle into overdraft. These are not just overdraft fees, but whatever fees are assessed in connection with the account, such as monthly maintenance fees, stop payment fees, check orders, wire transfers, various other transaction fees and fees for returning items drawn against insufficient funds.

- Not all debit card transactions are authorized. Certain small dollar debit card transactions (luggage carts at airports, for example) and other types of debit card transactions at merchants who have a floor limit that allows purchases to be approved without authorization are not authorized in advance. Under the Board's proposed exception, the actual purchase amount of the transaction literally will not exceed the authorization amount when there is no authorization, and the depository institution will not know that these transactions are coming and will have no way to place a hold on them.

(d) The Opt-Out Requirement Will Have Adverse Impacts on Consumers, Depository Institutions and Merchants

In addition to the foregoing problems with the opt-out requirement as proposed by the Board, there are significant adverse impacts of the Board's opt-out requirement—or any op-out requirement for that matter—which lead us to conclude (as recommended below) that the Board should replace the opt-out requirement with a disclosure of certain options available to the consumer from the depository institution.

We are concerned that any requirement to provide consumers with a right to opt out of the depository institution's exercise of discretion as to whether or not to pay overdrafts will send consumers the wrong message, *i.e.*, the message that it is better to have transactions bounce or be denied than to have them paid. Occasionally it may be better to have a transaction denied if the consumer does not have available funds (such as the discretionary cup of coffee from the coffee shop), but we believe it is apparent that most of the time it would be better for the consumer to have the transaction completed and that most of the time consumers would rather have their transactions completed. Part of the concern expressed by the Board with respect to small dollar debit card POS transactions may arise more from a misunderstanding by the consumer that the bank would not authorize the transaction if he or she didn't have the funds, and that kind of misunderstanding can easily be addressed, not by a right to opt-out, but by a simple disclosure by the depository institution of what its practice is with respect to such authorizations. As discussed in detail above in this letter, bounced transactions clearly result in more harm to the consumer than the cost to the consumer of the depository institution paying the overdraft. Even denied debit card POS transactions more often than not can result in greater harm when the consumer is unable to complete a transaction for necessaries, or suffers unwanted delay or embarrassment at the point of sale by not being able to complete the transaction. Not only the manner in which the Board has proposed the opt-out requirement with its strong bias against payment of overdrafts, but the very existence of an opt-out requirement from federal banking regulators will make it appear to consumers to be a better option than it really is, and when there is another simpler, clearer way to reach the same result by disclosure, the Board should seriously consider the alternative.

We are also concerned that this proposed opt-out requirement is the first time we can recall where depository institutions are being forced into providing consumers a right to opt-out of a particular product feature and out of retained discretion by the institution, and that there is no natural boundary at which this kind of intrusion into a depository institution's product design can come to a halt. Mandating a consumer opt-out of a product feature is a difference in kind from existing privacy opt-outs under the Gramm-Leach-Bliley Act or the Fair Credit Reporting Act, and it appears that the Board may simply be translating a process that is utilized in the privacy context into the product design context without fully considering the differences between these two contexts and the consequences of doing this. In the privacy world, an opt-out is a way for the consumer to have some control over use of information about himself or herself, and while it is true that such information belongs both to the depository institution (as proprietary customer information) and to the consumer (as personal information about the consumer and the consumer's transactions), there are clearly recognizable rights of the consumer in such information, and thus it is appropriate to grant the consumer some degree of control over how the information is used. The world of product design is different. Consumers have no rights in a depository institution's product design or, other than through decisions about whether or not to do business with the institution, to dictate to the institution what kinds of products it should offer or how such products should be designed or structured. Thus, giving consumers a right over how deposit accounts are structured or over whether a depository institution can exercise retained discretion with respect to that product goes beyond the boundaries of what is traditional or even appropriate. Consumers have the right to vote on bank products like they have the right to vote on any other products offered to consumers—with their feet by deciding to buy or use the products or not. And depository institutions—like other sellers of products—compete for those customers with the types of products and product features they offer. The Board's opt-out requirement (or any opt-out requirement for that matter) in this product design context becomes a restriction on competition by starting down the path of feature design and price control. Feature or product design control is appropriate to the extent such control is designed to avoid hazardous products or fraud or misrepresentation, but as indicated many times already in this letter, what the Board is granting the right to opt out of—the payment of overdrafts—is a feature that is a significant benefit to consumers, and is thus not the type of product feature that should be subject to design controls intended to promote safety or fairness. Again, this is particularly the case here where the apparent concerns about potential misunderstandings by consumers about how the product works can easily be addressed by disclosure.[28]

We have already expressed in this letter our further concerns about the potential impact of the exercise of the Board's proposed opt-out by significant numbers of consumers on the economy and on merchants, and these, together with the very significant costs of the Board's proposal for depository institutions, are further reasons for replacing the Board's proposed opt-out requirement with targeted disclosures designed to address the specific problems which the Board has identified with debit card POS transactions.

We have also given thought to a potential implementation of what in effect works like an opt-out, but is not an opt-out *per se*, but is rather a process of providing incentives for, or possibly mandating, the offering of options or features that give consumers similar kinds of choices as would be the case with an opt-out requirement. For example, if a depository institution were to offer not only a checking account that provided an "automatic enrollment" in an overdraft protection feature with associated overdraft fees, but also offered a checking account that did not have such a feature, or simply offered more clearly an option on the first type of checking account to have the feature turned off if the consumer wanted to do so, the consumer could still be provided with a reasonable opportunity to avoid overdraft fees, or at least

[28] By eliminating the regulatory distinction between "promoted" and "non-promoted" overdraft programs, the Board is enhancing the ability of depository institutions who do not want to promote "bounce protection" to nonetheless be able to provide more information (disclosure) to their customers about how the institution's overdraft protection programs work so as to help avoid just such misunderstandings.

reduce the likelihood of incurring overdraft fees. Even the Board's proposal, with its two exceptions, does not completely offer escape from overdraft fees.

What the Board has to recognize, however, is that whether through an opt-out requirement as the Board is proposing, or through an arrangement to require optional accounts or optional features on accounts, there is never going to be the simple option of giving the consumer on the one hand a way to avoid all overdraft fees on an account and eliminating for the bank on the other hand the risks of ever having to pay overdrafts on that account. The reality of the payments systems involved here is that there is no way to eliminate all possibility of overdrafts on an account, and in fact, there are, as illustrated above in this letter, many ways beyond the two very limited exceptions provided by the Board in its opt-out proposal in which such overdrafts can occur that the depository institution cannot avoid. Thus, the Board has to recognize that the costs of overdrafts—which are a core component and risk of a bank account and not just some add-on feature—have to be factored into the risk and profitability matrix that makes it possible for an institution to offer the account, which has to mean that government mandated accounts (whether through an opt-out requirement or some requirement to offer certain product features) that still cannot eliminate the risk of overdrafts, but nonetheless do away with charging for them, have a different risk and pricing matrix than accounts that do charge for overdrafts. Put simply, if overdraft fees are prohibited on account type A and are permitted on account type B, then account type A will have to find some way to compensate for the prohibited overdraft fee through some other fee or pricing mechanism (such as a no waiver minimum balance fee or an account maintenance fee) or some other reduction in risk (for example, longer Regulation CC holds on deposits or more limited opportunity to have a debit card or imposing debit holds on pending transactions for which the institution currently does not impose such holds), because the corresponding risk of overdrafts occurring cannot be eliminated, and will in fact still be a fairly common occurrence.[29]

By going down the path of this proposal the Board has necessarily entangled itself in the intricacies of bank product design and pricing, which is typically not the province of government in our regulatory system. This is again why we believe, as recommended below, that the most effective way for the Board to address the primary issue with overdrafts—concern with excess debit card POS transaction overdrafts and the costs of overdraft fees in relation to small dollar debit card POS transactions—and also avoid as much as possible entanglement in product design and pricing is to rework the opt-out requirement into a disclosure which continues to allow depository institutions to offer product variation and innovation without the mandates of opt-out or product features.

[29] We also note that if the Board's proposed opt-out requirement is implemented, it is likely to result in substantially higher numbers of returned items, which may also require depository institutions for risk purposes to reconsider when deposited funds are made available within the requirements of Regulation CC.

Issues with the Board's Proposed Holds Prohibition

The Board's holds prohibition states that a depository institution must not charge a fee for an overdraft if the overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual purchase or transaction amount. Thus, this prohibition applies whether or not the consumer has opted out of overdrafts. It also applies to any "excess" hold on a pending item regardless of the type of item, although it appears directed primarily at excess holds that arise as a result of debit card POS transactions.[30] As discussed above, this prohibition is apparently not intended to prevent charging an overdraft fee at the time of settlement of the pending transaction if there are insufficient funds at the time of settlement to cover <u>that</u> pending transaction.[31] Rather, the prohibition apparently is against charging overdraft fees on <u>other</u> intervening transactions posting against the account while the hold for the pending transaction is still on the account if the excess portion of the hold is the reason for those other intervening transactions going overdraft.

The major problem with this holds prohibition is its predict-the-future feature in that the depository institution cannot know whether the hold on the pending transaction will be "excess" or not until after the other intervening transactions have posted, and thus the institution cannot know until it is too late whether or not it is prohibited from charging any overdraft fee (assuming the consumer has not opted out) on those other intervening transactions that are paid into overdraft. This holds prohibition is thus unworkable because it requires depository institutions to know what will happen in the future before the institution can assess overdraft fees, and it leaves depository institutions with only two unacceptable choices. The first is to stop charging any overdraft fees on any overdraft that is paid during a hold on any pending item, since the depository institution can never be sure that the pending item will not settle for an amount less than the amount of the hold. The second is to stop placing holds on any pending items. Both of these unacceptable options are safety and soundness risks to the depository institution by either depriving the institution of fee income that is intended to offset the risk of paying overdrafts or keeping the institution from holding funds to make sure they are available when the pending item is required to be paid at the time it settles.[32]

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[30] All of the examples provided in the proposed Commentary are of a debit card POS transaction. Additionally, the supplementary information states that "[d]ebit holds occur when a consumer used a debit card . . .." If the Board only intends this holds prohibition to apply with respect to pending authorization holds for debit card POS transactions, the Board should make that clear.

[31] As indicated in the Board's proposed Commentary, this provision "does not limit a bank from charging an overdraft fee in connection with a particular transaction . . . if the purchase or transaction amount for the transaction for which the hold was placed would have also caused the consumer to overdraw his or her account." Proposed Comment 227.32(b)-1.

[32] Generally, debit card POS transactions that have been authorized by the institution are force-pay items when they settle. Debit card POS transactions that have not been authorized by the merchant (typically for small dollar transactions) can be charged back by the depository institution, but it generally is not cost-effective for the institution to charge back small dollar items to the merchant.

There are several reasons why the depository institution may not know for sure whether or not a pending item which is a debit card POS transaction will settle for an amount less than the amount of the hold placed on the pending item. This potential difference between authorization amount and transaction settlement amount is primarily a function of the way the payments system for signature debit card POS transactions operates.[33] The merchant, or the merchant's processor, obtains an authorization from the depository institution that issued the debit card (unless the authorization is denied) for an amount determined by the merchant or the merchant's processor at the time the debit card is swiped in the merchant's card reader device, and it is typically that authorization amount which the depository institution uses as the amount of the authorization hold.[34] The transaction then typically takes three to five days to settle (or longer) with the depository institution, depending on how frequently the merchant sends out its transactions for settlement. It is our understanding that depository institutions generally maintain authorization holds only for a set number of days (for example, three days) within which they expect most such transactions to settle, which means that if the merchant is slower in processing the transaction, the institution's hold could be released before the transaction settles.[35] In contrast, PIN-based debit card POS transactions settle within two hours (and usually within a few minutes) of the time of the transaction, and thus generally do not involve any holds being placed on authorization amounts.[36]

Generally it is our understanding that roughly two-thirds of signature debit card POS transactions settle (or are expected to settle) for the same amount as the authorization amount and approximately one-third involve authorization holds that are estimates and more likely to vary from the actual transaction amount that settles. As indicated previously in this letter, of the one-third that are generally estimates, virtually all are either gas pump or restaurant transactions.

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[33] "Signature" debit card transactions do not necessarily always have a signature of the consumer. For example, debit card transactions at gas pumps don't have a consumer signature but are nonetheless "signature" debit card transactions. Generally, a "signature" debit card transaction is one where the consumer is not required to enter a personal identification number or PIN.

[34] In the supplementary information, the Board states that "the merchant (and in some cases the card-issuing bank) [places] a hold on the consumer's account . . .." 73 FR, at 28931, col. 2. More accurately, it is the merchant that places the authorization request and determines the amount of the authorization request, but it is the depository institution that decides whether or not to place a hold on the account based on the authorization. The authorization process is intended, however, to be primarily for the benefit of the merchant in that generally the depository institution cannot charge the transaction back to the merchant if the transaction has been authorized.

[35] In the supplementary information, the Board states that "[t]ypically, the hold is kept in place until the transaction amount is presented to the financial institution for payment and settled." 73 FR, at 28931, col. 3. This is not a correct statement for our institution and probably many (if not most) other depository institutions.

[36] There is some risk that another transaction will be authorized between authorization and settlement of the PIN-based debit card transaction, but the window is short, and so the risk is small. Additionally, since the actual settlement amount does not get hard-posted to the account until that night's item processing routine, there is some risk that, depending on the depository institution's order of processing items, the PIN-based debit card transaction will pay into overdraft notwithstanding the fact that funds were available at the time of authorization earlier in the day.

Restaurants either authorize the transaction based on the amount of the charge without including tip, and then adjust the transaction before sending it out for settlement to include the tip, in which case the transaction would settle for a higher amount than the authorization, or they estimate the amount of the tip at the time of authorization, resulting generally in transactions that settle for an amount that nominally differs from the authorization amount, either higher or lower. Gas pump transactions have in the past been primary examples of authorization holds that can exceed the actual transaction amount, but new procedures being implemented by the card associations will have the effect of making these transactions work like PIN-based debit card transactions and thus generally eliminate holds that differ from the actual transaction amount.[37] The remainder of estimated transactions (generally 1 or 2 percent) are for travel and entertainment merchants, such as hotels, resorts, cruise lines and car rentals, but these are not only a very small percentage of overall debit card POS transactions, but are also the kinds of transactions more likely to be engaged in by consumers of more ample means who are less likely to have their accounts overdrawn because of authorization holds. Furthermore, many institutions do not hold for these kinds of travel and entertainment authorizations as a risk decision because of the potential inconvenience to customers and the institution's limited loss experience with these kinds of transactions. However, for all signature debit card POS transactions, even including the two-thirds of transactions that are expected to settle for the same amount as the authorization, the authorization amount and settlement amount can differ because of merchant or merchant processor errors, multiple card swipes by the merchant that create multiple authorizations,[38] failure of the merchant or merchant processor to transmit the merchant code or the right merchant code, or other actions of the merchant or the merchant's processor. The Board's proposed holds prohibition does not provide any margin for error, but is simply an outright prohibition, and thus as indicated above the only way the depository institution can be certain that it will not violate the holds prohibition is to avoid the possibility of overdraft fees being assessed during a hold on a pending item or not to place holds on pending items.

This significant adverse impact of the holds prohibition on depository institutions which largely arises out of circumstances beyond the institution's control is thus out of all proportion to the likely incidence of holds on pending items—and particularly holds on debit card POS authorizations—causing other intervening transactions to overdraft the account. The Board appears to be primarily concerned that consumers may not know that holds for pending items are placed on the account or how long such holds remain in place, but as indicated above in this letter, depository institutions provide many different means for consumer's to track their transactions and balances in ways that generally enable consumers to know that a hold is in place and when the transaction settles. By proposing the holds prohibition, the Board has provided a

[37] Visa, for example, is starting in October 2008 to allow gas stations to use a procedure where the authorization (say for $75) will be modified within two hours (but usually within minutes) to the actual amount of the purchase (say $50), meaning then that any hold placed by the depository institution on the account will reflect that modified authorization amount ($50), and thus when the transaction settles a few days later, it will settle for the same amount ($50) as the authorization hold.

[38] Depository institutions typically have programming to try to identify multiple swipes so as not to create multiple authorization holds, but those programs do not catch every such occurrence.

remedy that is out of all proportion to the problem intended to be addressed, since the occurrence of excess holds that potentially cause other intervening transactions to overdraw the account is relatively infrequent, and the Board is not adequately recognizing the complexity of the payments systems involved or the balancing and other mechanisms that are part of those payments systems and their customary ability to adapt and improve to the mutual benefit of all participants.

We Recommend Disclosure of Options Rather Than Opt-Out

The primary focus of the Board's concerns in the proposal appears to be with debit card POS transactions that overdraw accounts, because consumers may expect that the transaction will not be authorized if funds are not available in the consumer's account, as well as because many debit card POS transactions can be for small dollar amounts which then result in overdraft fees that are more than the amount of the transaction. Thus, instead of the current proposed opt-out requirement, we recommend that the Board consider a more narrowly targeted solution that focuses on debit card POS authorizations if funds are not available at the time of authorization under whatever system the depository institution has in place for determining such availability.[39] If consumers were better aware that the institution may choose to authorize debit card POS transactions even when funds are not available at the time of authorization (if that is the institution's practice), and were aware of other options the institution may offer (such as an option to ask the institution to turn off this feature or to have an account that does not automatically cover discretionary overdrafts), they would be in a better position to avoid overdrafts and associated overdraft fees for these types of transactions. Such an approach can provide a result for debit card POS transactions similar to a more formal opt-out process, without all of the complication, burden and compliance risk of a formal opt-out process.

Thus, we recommend that the Board's proposed opt-out requirement be replaced by the following account level disclosures: (i) whether the depository institution may approve authorizations for debit card POS transactions even if the consumer has no available funds at the time of authorization under whatever process the institution uses to determine such availability of funds; (ii) how the consumer can ask to turn off such authorizations; and (iii) whether the institutions offers accounts which do not have this authorization feature when funds are not available.

If consumers really care about this, then institutions that do not offer ways to avoid debit card POS authorizations when the consumer does not have available funds in the account will be

[39] We note that debit card POS transactions that are approved at the time of authorization, or that are consummated at the point of sale without the merchant obtaining an authorization, could still overdraw the account at the time such transactions are settled and thus result in overdraft fees at that time. That would be more likely to happen in the case of transactions that were not authorized, for which it appears there should be an exception anyway even under the Board's proposed opt-out requirement. For authorized transactions, the institution's hold on the funds will generally preserve the availability of those funds when the transaction settles, except under the various circumstances (such as those described earlier in this letter) when unavoidable intervening transactions would use up that availability, which also should be exceptions even under the Board's proposed opt-out requirement.

at a competitive disadvantage, with the result that a market with better disclosed options can create more or less the same result for consumers as a complex, burdensome and risk-filled opt-out requirement without entangling the banking agencies in the web of product design and pricing. As discussed above in this letter, this proposed opt-out requirement would be the first time that the Board and the other banking regulators are creating a complex and formal opt-out process with respect to a feature of a consumer product, in this case, deposit products. Doing so raises the question of where this kind of thing naturally stops. If consumers should have the right to opt-out of a depository institution's discretion whether or not to pay (and charge for) overdraft items—and worse, if not having such right is "unfair"—there is no reason why some other feature of some other product or account shouldn't also have the same consumer "choice" built into it, with the eventual result that institution product design and pricing is turned over to banking regulators requiring a medley of choice to consumers for account or product features, rather than allowing institutions the opportunities for variation and innovation to design their products based on competitive acceptance of such products in the market.[40]

Providing disclosures for debit card POS authorizations where funds were not available would provide a form of consumer choice that would also compensate for the fact that there is not any feasible way under current technology to provide that kind of choice per transaction at the point of sale. This is where debit card POS transactions differ from ATM transactions, because we believe that most depository institutions provide choice today at their own ATMs for the consumer to be notified on the screen if the ATM transaction will overdraw the account (as of that point in time based on how the institution determines availability for this purpose), and the consumer can elect to go forward with the transaction or not.[41] That technology is available at the point of transaction for ATMs (at least for the institution's own ATMs), where it is not available today in the case of POS transactions, and thus we do not believe there is the same case for providing a general opt-out right or additional options for ATM transactions. Furthermore, it seems clear from the Board's proposal that check and ACH overdrafts do not raise significant issues that need to be addressed in this proposal. Likewise, debit card transactions where the card is used for recurring payments also do not appear to be a significant issue and are more like ACH transactions in that regard. That leaves the debit card POS transactions, and thus we believe that the Board should limit any solutions at this time to those transactions.[42]

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[40] Notwithstanding all of the foregoing, if the Board nonetheless determines to maintain some kind of formal opt-out requirement, that requirement should at least be limited to providing a right to opt out of the depository institution authorizing debit card POS transactions if the account does not have available funds at the time of authorization based on whatever method of determining availability the institution uses.

[41] Providing this option at ATMs is stated to be a best practice in the banking agencies' 2005 Joint Guidance on Overdraft Protection Plans, 70 FR 9127 (Feb. 24, 2005), at 9132.

[42] Depository institutions are today generally unable to provide an opt-out choice at the point of transaction for ATM transactions by customers of the institution at ATMs not owned or operated by that institution. However, before the Board would include such non-proprietary ATM transactions within any general right of opt-out or other option, it would be appropriate for the Board to determine the extent to which this kind of transaction is a significant issue. Even the provision of a general opt-out right for such transactions is likely to be difficult to implement

One final part of any opt-out rule should be that the Board makes clear that nothing in the rule is intended to require depository institutions to pay overdrafts, or offer any type of overdraft protection service, for any types of items that may overdraw the account.

Before leaving our disclosure recommendation, we need to acknowledge and respond to the Board's comments on disclosures in the proposal which otherwise might indicate that a disclosure option may not be viable in place of an opt-out requirement. The Board states that "the Agencies remain concerned about the adequacy of disclosures provided to consumers regarding the costs of overdraft services." 73 FR, at 28928, col. 2. However, the Board does not explain what about current disclosures to consumers is not adequate. Overdraft fees are disclosed in a depository institution's account opening disclosures (typically in a fee schedule) under Regulation DD, and are disclosed on the account statement when they are assessed. Currently, under Regulation DD depository institutions that "promote" overdraft protection plans have additional disclosure requirements on statements of totals of overdraft and returned items fees for the statement period and year-to-date, and the Board's Regulation DD proposal that supplements this UDAP authority rulemaking expands that additional disclosure requirement to all depository institutions. Furthermore, many (probably most) depository institutions send consumers a separate notice after overdraft fees are incurred which also indicate the amount of overdraft fees that have been incurred. What is inadequate about all of this disclosure of overdraft fees is not apparent. Additionally, in the legal analysis discussion of the opt-out requirement, the Board makes statements referenced earlier in this letter that "consumers often lack sufficient information about key aspects of their account" and "cannot know with any degree of certainty when funds from a deposit or a credit for a returned purchase will be made available". 73 FR, at 28929, col. 2. These statements indirectly suggest that disclosures provided are not sufficient to enable a consumer to figure out his or her account balance or track transactions so as to be able to avoid overdrafts, and we have commented above how these statements cannot be an accurate reflection of the reality of how bank accounts work and what information is available to consumers. These comments on disclosures, or their potential inadequacy, are either not sufficiently explained or are inconsistent with what is in fact available and useful for consumers, and thus it does not appear that the Board has articulated any sufficient reason not to consider disclosure options as an alternative to an opt-out requirement.[43]

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because of the general lack of control by the consumer's depository institution over what happens at the non-proprietary ATM and concerns with timing delays and relatively stale data.

[43] This contrasts sharply with some of the Board's comments in the credit card portion of the proposal, such as under the proposal to regulate application of increased rates to outstanding balances where the Board states that "[a]lthough the disclosures proposed by the Board under Regulation Z should, if implemented, improve consumers' understanding, disclosures alone may not be sufficient to enable consumers to avoid injury. Consumers may ignore the disclosures because they overestimate their ability to avoid the penalty triggers." 73 FR, at 28918, col. 1. The Board refers to this as "hyperbolic discounting" (see the Board's footnote 47 on this same FR page) pursuant to which a consumer may believe a particular disclosure will not be applicable to him or her and thus does not give it sufficient attention. However, if disclosures are *per se* insufficient because consumers may ignore them or may discount their applicability, and if that is a reason why disclosures are ineffective and other solutions are required,

The Board Should Eliminate the Holds Prohibition and Replace It with a Merchant Disclosure Requirement

Instead of the current proposed holds prohibition, the Board should consider a more measured solution that is commensurate with the relatively infrequent incidence of the problem to be addressed by proposing a simple disclosure requirement for merchants at the point of sale that would alert consumers of the possibility of merchant authorizations that could result in holds on the consumer's account and that would recommend that the consumer check his/her balance before performing subsequent transactions. Some merchants (some hotels, for example) already provide this kind of disclosure on counter signs at the time of check-in. If necessary, a similar disclosure could be provided by depository institutions as part of account opening disclosures.

Other Matters

(a) Duration of Opt-Out

The proposed opt-out requirement allows the consumer to opt-out of future payment of overdrafts at any time, requires depository institutions to comply with the consumer's opt-out request as soon as reasonably practical after the institution receives it, and makes the opt-out effective unless subsequently revoked by the consumer. While we generally do not object to this series of requirements (assuming the opt-out right itself is even necessary or is narrowed as set forth above in this letter), we nonetheless point out that this series of requirements will allow consumers to game the system by making debit card transactions today that are authorized into overdraft, and then immediately thereafter calling the depository institution's toll-free number to opt out of payment of overdrafts so that when the debit card transactions settle into overdraft a few days later the institution cannot charge overdraft fees, and then thereafter revoking the opt-out and starting the process all over again.

To deal with this potential problem, there should be some limits on the ability of the consumer to flip-flop back and forth between opting out and revoking the opt-out.

(b) Exclusion of Formal Overdraft Protection Products

We note that the Board has excluded from the term "overdraft service" formal overdraft credit lines that are subject to Regulation Z, including transfers from separate credit card accounts, home equity credit lines or other lines of credit, as well as overdraft protection available through transfers of funds from other deposit accounts of the consumer. We agree that

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then it is not clear why depository institutions are required to provide any of the myriad of disclosures now required for all types of consumer products and services. If the Board is saying that disclosures of fees are insufficient to justify charging the fee, then under what circumstances is it permissible for a depository institution to charge any fees? This kind of reasoning is clearly wrong and at odds with decades of federal law espousing the principal that disclosure is effective and worthwhile even if some consumers don't pay attention to it.

all of these more formal means of overdraft protection should be excluded from the Board's overdraft proposal.

(c) Posting Order

The Board has solicited comment about whether the Board should propose an order of payment rule that would require depository institutions to pay low-to-high for purposes of assessing overdraft fees, but allow the institution to provide a different order of payment if that was disclosed to the consumer and the consumer opted in to such different order of payment. We strongly recommend that the Board not start mandating rules about order of payment in the highly complex world of item processing. To have any particular order of payment mandated by a specific rule—regardless of whether that rule is based on UDAP authority or other regulatory authority and regardless of what the rule is—would create the potential for significant litigation and reputation risk solely on the basis of the complexity of item processing which may be very difficult to make compliant with a simple order of payment rule. Furthermore, there are advantages and disadvantages to the consumer and to the institution with respect to any particular order of payment, and the Board should not be in the business of mandating those kinds of choices or elevating any one option over another. Depository institutions differ from one to another in what posting order they currently apply for various reasons that are important or efficient for the particular institution, and there is no way that imposing one particular order of payment on all institutions would accomplish payments system efficiency. Particularly where institutions are moving toward near real time clearing of items for on-line electronic transactions, imposing a rule that requires a payment order based on same-day size of the transaction will inhibit any ability to develop real time processing or other forms of item processing innovation.

Additionally allowing for an opt-in for consumers who may want a different order than the proposed mandated low-to-high is not practical because (at least in our case, and we assume this would hold for most other depository institutions) the institution can have only one order of payment for its item processing routine and not multiple ones that would vary from one consumer to another depending on consumer choice. In addition to the very significant reprogramming issues such multiple variations would entail, there is simply not time in the processing day to accommodate multiple routines.

(d) Compliance Transition Period

Lastly, the Board has solicited comment on whether a one-year time period is appropriate for implementation of any final rule. We believe that one year is the absolute minimum that would be needed, depending on what the final rule actually requires and how much lead time will be needed for reprogramming and other changes that would need to be implemented. Eliminating the holds prohibition, for example, would eliminate one source of implementation delays, but it would still take a significant amount of time to implement any opt-out requirement and applicable exceptions. Thus, we recommend at least two years for institutions to come into compliance.

Thank you for the opportunity to provide these comments.

Very truly yours,

Daniel W. Morton

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