INDEPENDENT COMMUNITY BANKERS of AMERICA

CYNTHIA L. BLANKENSHIP
Chairman
R. MICHAEL MENZIES
Chairman-Elect
JAMES D. MACPHEE
Vice Chairman
LARRY W. WINUM
Treasurer
WILLIAM C. ROSACKER
Secretary
TERRY J. JORDE
Immediate Past Chairman

CAMDEN R. FINE
President and CEO

August 4, 2008

Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Docket No. R-1314

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
Comments on Proposed Rule Part 706

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: OTS-2008-0004

Re: Unfair or Deceptive Acts or Practices
Consumer Credit Card Accounts and Overdraft Services for Deposit Accounts

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on interagency proposed rules that would substantially change the rules governing community banks' consumer credit cards and overdraft protection programs. The Board of Governors of the Federal Reserve, Office of Thrift Supervision

[1] The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold more than $1 trillion in assets, $800 billion in deposits, and $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

(OTS) and National Credit Union Administration (NCUA)[2] ("the agencies") are preparing to exercise their authority under Federal Trade Commission (FTC) Act Section 5(a) and adopt rules on unfair or deceptive acts or practices (UDAP). If adopted, the proposal would prohibit banks, thrifts and credit unions from engaging in certain acts or practices involving consumer credit card accounts and overdraft services. The proposals were drafted to address complaints raised by consumers and members of Congress about practices perceived as unfair or deceptive. Separately, the Federal Reserve has issued two companion proposals that apply to credit cards and overdraft protection services.

Overview of ICBA Comments

ICBA believes it is ill-advised to develop rules governing specific credit card and overdraft protection practices based on UDAP. While we appreciate the rationale that prompted this approach, using UDAP instead of developing rules under Regulation Z for credit cards or Regulation DD for overdraft programs has several critical flaws. To begin with, any rule based on UDAP instantly creates an unfair playing field. The Federal Trade Commission (FTC) has not indicated any intention of drafting parallel rules for non-depository entities subject to FTC rules. Therefore, the agencies' rules will be limited to depository institutions; non-depository institutions will not be subject to the same standards. This same disparity in regulatory treatment can be blamed for pushing consumers seeking mortgage loans away from highly regulated and closely supervised depositories towards other loan providers. It makes no sense to replicate that error for other consumer financial products.

Perhaps more important, by defining a practice as unfair or deceptive, it cannot be limited to prospective application. Therefore, any practices defined as inherently unfair or deceptive under UDAP must have been unfair or deceptive when they took place, regardless of business standards or regulations in place when the transactions occurred. Certainly, any UDAP rule will be used in that manner by state attorneys general and the plaintiffs' bar.

Instead of developing a UDAP rule, ICBA firmly believes consumers, bankers and the agencies would be better served by continuing to apply UDAP on a case-by-case basis, an approach that has worked effectively to date. Those that believe a UDAP rule is necessary must understand the limits and ramifications of a UDAP rule. Equally important for consumers, the proposed restrictions will be costly and burdensome for banks to provide, and the increased costs will eliminate providers that only offer these products as a customer convenience. This will limit options for consumers. And, increased costs resulting from the proposed changes will also serve to drive consumers – especially marginal consumers – away from depository institutions to less scrupulous providers. Finally, to manage risks, depository institutions may be compelled to deny

[2] The rule issued by the Federal Reserve would apply to all commercial banks. While the agencies are working closely with the FDIC and Office of the Comptroller of the Currency (OCC), neither the FDIC nor the OCC has rule-writing authority under current law. Although the House of Representatives passed legislation to give the FDIC and OCC the authority to write rules for state non-member banks and national banks, respectively, the Senate has not yet acted.

some customers access to banking products and services, further alienating these consumers from the banking sector and encouraging them to rely on less regulated non-bank providers.

Overdraft Services. Most community bank customers welcome overdraft protection as a convenient, valued service. While ICBA agrees that providing customers a notice and an opportunity to opt-out is appropriate, requiring the full opt-out notice in every statement cycle where there is an overdraft will result in information overload for consumers and be unnecessarily expensive and burdensome for providers. Since the proposal requires depositories to include information about fees on statements, consumers will have the information needed to help them understand the impact of overdrawing an account. Providing the full notice once each year should be more than adequate. And, limiting the notice to once each year will make it more likely consumers will pay attention to the notice.

While requiring banks to offer customers an opt-out from overdraft protection is acceptable, requiring banks to offer a partial opt-out is completely unworkable. In fact, a partial opt-out may be sufficiently burdensome and operationally challenging that many community banks will abandon overdraft protection services entirely and simply return or reject any transaction that would overdraw an account. Without overdraft protection services in place, consumers will still face a virtually identical fee from the bank, but will also have to contend with additional problems, including additional merchant fees, a negative entry on a credit report or check verification system, and being required by merchants or others to remit payments using cash, money orders or cashier's checks, to say nothing of the embarrassment suffered when a transaction is rejected.

If a customer opts out but engages in transactions that overdraw the account, the bank may be compelled to close the account, deny continued use of a debit card or otherwise restrict services as a way to control risk and ensure safe and sound operations. And, while it is useful to alert customers to possible alternatives to overdraft protection programs, not all customers will be eligible for or willing to take the steps needed to qualify for alternatives.

Credit Cards. Overall, the proposed changes for consumer credit card accounts will be difficult to implement from an operational perspective and will very likely result in increased fees and charges to the customer. While it is reasonable to require issuers to mail a statement 21 days before payment is due, prescribing how payments are applied to outstanding balances will change the dynamics of the credit card industry. Similarly, restricting interest rate increases for existing balances will be difficult operationally and may cause overall interest rates to rise to compensate for potential future risks that cannot be assigned to individual performance. And, it will be operationally difficult to handle the amortizations proposed for balances that were outstanding at the time an interest rate increased. Fundamentally, the operational difficulties inherent in the proposed changes will increase costs for providers that will be passed on to consumers. Moreover, the costs and burdens are likely to cause some smaller providers to discontinue services, limiting customer choice, and the increased costs are also likely to deny credit to marginal

consumers. These unintended consequences are a step backward and will sap the vitality of the credit card industry.

Holds. For both overdraft programs and credit cards, the ability to process holds and reconcile transactions in the manner required by the proposed rule will be operationally difficult and costly. In fact, it may be necessary for extensive manual processing to comply. For example, if a hold would cause any subsequent transaction to overdraw an account and a customer has opted out for debit cards, the only workable solution for the bank may be to reject any future transactions until the hold is released. The restrictions may cause banks to eliminate the hold process as a means to control risk or seek ways to transfer the risks to merchants. Already the market is working to address these problems,[3] but before any rules are imposed, a much clearer understanding of how the process works, who benefits from holds, where the best point of contact to address the problem is, and the true impact caused by holds before adopting rules that could have serious – and very negative – unintended consequences.

Background

In recent years, a great deal of attention has been given to credit cards and overdraft protection programs. In 2005, the federal banking agencies developed interagency guidance to encourage banks to take appropriate steps for handling overdraft programs in a safe, sound and responsible way. In 2007, the Federal Reserve proposed extensive changes for credit card disclosures. For these latter changes, the Federal Reserve conducted consumer research to develop more meaningful disclosures but found there are limits to what disclosures can accomplish. Separately, the OTS examined the possibility of developing rules under UDAP to address consumer issues. Currently, several bills are pending in Congress that would restrict certain credit card and overdraft protection program practices. All these developments have culminated in the current proposal.

The banking agencies clearly have authority under the FTC Act to stop unfair or deceptive acts or practices. Previously, the agencies have addressed problems on a case-by-case basis. Now, though, the agencies propose to develop rules that would identify certain acts or practices as presumed unfair or deceptive.

Under the FTC Act, an act is unfair if it: (1) causes or is likely to cause substantial injury to a consumer; (2) is not something the consumer could reasonably avoid; and (3) is not outweighed by countervailing benefits to the consumer or to competition. Meanwhile, an act is deceptive if: (1) there is a representation or omission likely to mislead a consumer who is acting reasonably under the circumstances, and (2) that information is material to the decision-making process. According to the FTC, an unfair act or practice most always represents a failure or imperfection in the market, but the central focus is injury to the consumer.

---

[3] VISA recently announced an entirely new system that will move much closer to real-time processing for holds at the gas pump, one of the most contentious areas. Those changes take effect October 1 and should alleviate much of the problem.

Overview of the Proposal

Under the proposal, the first step would create a new UDAP rule divided into four subparts. Subpart A of the rule would outline the authority, purpose and scope of the rule. Existing rules on credit practices and co-signers would be moved to Subpart B of the new rule.

The first substantial new addition would be seven new provisions on consumer credit card accounts as Subpart C. If adopted:

1. Banks[4] would be prohibited from treating a payment as late unless consumers are given a reasonable amount of time to make the payment. The proposal would create a safe harbor for a creditor that mails or delivers the statement 21 days before the payment is due. If the date the payment is due is a date where the creditor does not accept payments or the Post Office does not deliver mail then a payment received the next business day could not be treated as late.

2. Where different interest rates apply to different balances of an account, banks would have to allocate payments that are more than the minimum payment due by using one of three approaches: (1) applying the entire amount to the balance with the highest rate; (2) splitting the payment equally among the balances; or (3) splitting the payment pro rata among the balances. In addition, *if* the bank offers a grace period, it would have to let consumers take advantage of the grace period for purchases before requiring any balances carried at a promotional rate be paid.

3. Banks would generally be barred from increasing the interest rate on an outstanding balance.

4. Banks would be prohibited from charging an over-limit fee caused solely by a hold on the account.

5. Banks would be prohibited from charging interest based on a balance in a prior statement cycle (so-called "double cycle billing").

6. Creditors could not finance security deposits or fees for issuing a card or making credit available if the charges and fees are greater than the majority of the available credit. Moreover, if those fees and charges are more than 25% of the available credit, payment of the amount over 25% would have to be spread over the first year the account is open.

7. If a bank offers or advertises credit cards with multiple interest rates or credit limits, it also would have to disclose the factors used to determine the rate or credit limit a particular consumer might obtain or receive.

---

[4] As used throughout, the restrictions for banks would apply to all federal depositories.

A new subpart D would add two significant changes for overdraft protection services. The proposal would only affect overdraft protection services where the decision to pay a transaction that would otherwise overdraw the customer's account is automated and based on pre-determined criteria. It would not apply to overdraft credit, where the overdraft is covered by a draw on a separate line of credit, or overdraft balance transfers, where the overdraft is covered by a transfer from another account. If adopted, the proposal would prohibit fees for covering overdrafts unless the consumer is given a clear and conspicuous notice about the program and a reasonable opportunity to opt-out. Second, banks would be prohibited from charging a fee for an overdraft where the overdraft is caused solely by a hold on the account.

Using UDAP to Draft Rules

ICBA believes that any restrictions that the agencies adopt for either overdraft protection services or for consumer credit card accounts should be done through Regulation Z, Truth-in-Lending, for credit cards or Regulation DD, Truth-in-Savings, for overdraft services. It would be a mistake to use UDAP. While there may be a certain appeal to a UDAP rule and while the agencies have been "encouraged" to take this route, potential unintended consequences inherent in a UDAP rule must be considered. To begin with, adopting a rule as proposed will only apply to depository institutions and not other financial service providers. Non-depositories are subject to Federal Trade Commission (FTC) rules but the FTC has indicated no intention to adopt parallel requirements. As a result, the proposal instantly creates an unlevel playing field. Different restrictions and requirements for mortgage lending enticed consumers to turn to non-depositories for mortgages, a disparity that produced many of the mortgage problems confronting the economy today. In fact, the Federal Reserve was roundly criticized by some sectors for failing to take steps that would apply universally. It makes no sense to create a similar disparity in another area of consumer finance.

Defining an act or practice as unfair or deceptive in a UDAP rule also means the practice was always unfair or deceptive. Unlike other rules which can be limited to prospective application, defining an act or practice as unfair or deceptive cannot be limited to future application. The agencies may be able to limit their own treatment of UDAP through examination procedures. However, the plaintiffs' bar and state attorneys general are not subject to similar restrictions. Once the agencies identify an act or practice as unfair or deceptive in a UDAP rule, non-agency attorneys will hold that forth as the benchmark for court proceedings. It will be irrelevant that the activity or transaction in question was considered acceptable when it occurred. This alone should cause the agencies to pause before using UDAP for these rules.

General ICBA Concerns

While the proposed restrictions and limits in the proposals are ostensibly offered as "consumer protection," ICBA finds that the costs and burdens are very

likely to outweigh any benefits. Moreover, there are unintended consequences that could do more harm than good, especially for marginal consumers. When access to credit is increasingly important, actions that could decrease credit availability for consumers, especially marginal consumers, is ill-advised. Banks that earn only marginal returns but currently offer these products as a service for their customers are likely to discontinue them, thereby reducing competition and consumer choice. The more hurdles and challenges that must be overcome to provide a service, and the more costs and risks – including risk of examiner criticism and fines – the less likely a community bank will continue to offer a service.

Instead of protecting consumers, the restrictions are potentially a customer disservice. For example, while many community banks offer overdraft protection coverage as a much welcomed customer service, if costs or risks or challenges make it difficult – if not impossible – to continue the service, then community banks will cease offering overdraft protection and return or reject transactions. Most consumers operate their accounts responsibly and never encounter many of the fees in question. But there are times when, possibly due to an oversight or distractions, a consumer may forget to enter a check in his or her check register and inadvertently incur a transaction that would overdraw the account. Wouldn't he or she prefer the bank cover the overdraft instead of reject the transaction? Most community bank customers tell their bank they would prefer the transaction be processed. Rejecting the check or the transaction will not diminish bank fees since most banks impose the same fee for overdraft coverage as they apply to a returned check. However, in addition to embarrassment, the consumer is likely to incur additional returned check fees imposed by the merchant, negative entries on a credit report or check verification service, and may be required to remit future payments to a given merchant or service provider using cash, cashier's checks or money orders. In short, the changes may ultimately be a negative overall for consumers. Although some proponents cite studies that purport to show consumers would prefer having transactions that would overdraw an account rejected, ICBA urges the agencies to carefully analyze the methodology of these studies and to conduct their own assessment of consumer preferences before proceeding.

Finally, since the agencies increasingly encourage banks to be sensitive to risks and the ability to control for risks, ***ICBA believes it is critically important to recognize that some of these restrictions would remove tools that banks use to mitigate or control risk***. For example, if a customer has opted out and the bank can no longer charge a fee for overdraft protection, but over the course of a weekend incurs a series of transactions that are processed in such a way that they overdraw the customer's account, the bank may over time have to either deny the customer access to a debit card or, in the worst case scenario, close the account.

The UDAP Proposal

Subpart A – General Provisions

The proposal would first set out general provisions for "unfair or deceptive acts or practices" (UDAP). The proposal clarifies that this does not affect or limit the agencies'

general authority to enforce the Federal Trade Commission Act's prohibitions against other acts or practices.

ICBA continues to believe that it is preferable for the agencies to approach UDAP on a case-by-case basis. While rules usually provide consistency and specificity, that may not be the case with a UDAP rule. For instance, what may be entirely appropriate and workable for one consumer might not be beneficial to a different consumer with different experiences and different finances. For example, Regulation Z recognizes that some consumers are more sophisticated and therefore do not require regulatory protection.[5] Continuing to rely on a case-by-case approach lets an agency evaluate all pertinent factors before determining something is unfair or deceptive. If consistency is the goal, one approach might be to compile all UDAP decisions as a reference tool for bankers and examiners without resorting to a rule and the inherent unintended drawbacks.

ICBA also believes using UDAP adds to regulatory complexity and burden. For many years, community banks have confronted the complex difficulty of navigating a regulatory maze where the elements that govern one product or service are scattered throughout different rules and regulations administered by various agencies or different sections within an agency. This makes compliance difficult and inadvertent errors easy. It also makes it extremely difficult for consumers to understand the rules and regulations that govern consumer finance. This proposal would only add to that confusion by adding yet one more place and one new rule that affects consumer accounts. Adding new rules for credit cards and overdrafts in a new and different rule only increases the possibility for conflicting regulations, differing interpretations, and confusion.

A UDAP rule would have limited application and would not protect all consumers. As proposed, the rule would apply only to depository institutions. Non-depository providers would not be subject to these requirements. Developing rules under Truth-in-Lending and Regulation Z would create requirements that apply to all lenders, not just depositories.

Consumer Complaint

The proposal would include a new definition of a consumer complaint as "an allegation by or on behalf of an individual, group of individuals, or other entity that a particular act or practice of a [bank] is unfair or deceptive." Complaints submitted to a regulator should be written and should describe the act or practice in question and include the name and address of both the bank and the complainant. In turn, the regulator would respond within 15 days either with an answer or a reasonable timeline for when an answer might be sent. ***Generally, ICBA agrees with these requirements for consumer complaints.*** Requiring written complaints helps document the problem. However, ICBA believes that 15 days may not be realistic and recommends 30 to 45 days instead.

[5] Regulation Z exempts non-mortgage transactions that exceed $25,000 on the premise that only more sophisticated borrowers will engage in such high level loans. 12 CFR 226.3.

Subpart C – Consumer Credit Card Account Practices

The first major changes would be found in newly crafted Subpart C. These provisions generally would apply to consumer credit card accounts. Home-equity loans or lines of credit accessed by a card at an automated teller machine (ATM) clearly would be excluded. ***ICBA believes the exclusions are both logical and appropriate and supports retaining them.*** These are limited purpose cards and the distinction makes sense. Second, consumers are provided with ample information about these accounts that would be excluded as the result of requirements found in other rules. And, it is important to avoid consumer information overload. At present, ICBA is not aware of other types of transactions that should be excluded.

Promotional Rate. The proposal would introduce several new definitions. One new definition would be "promotional rate." While current credit card rules use the term "introductory rate," that term is inappropriate for special rates offered during the life of an account. Therefore, "promotional rate" is proposed to replace the term "introductory rate" and have a broader application for *any* annual percentage rate (APR) that applies to one or more balances or transactions for a specific period where that APR is lower than the APR that applies after the period ends.[6] ***ICBA supports the change and believes the term "promotional rate" is more instructive.*** This will make it clearer for consumers, bankers and examiners that a reduced rate can be both an introductory rate *and* a special rate in effect later in the life of a credit card account.

Payment Due Date (Section 22)

One of the more common consumer complaints about credit cards is that the payment due date changes or other steps make it difficult to avoid late fees or penalty rates. Currently, the Truth-in-Lending Act (TILA) and Regulation Z require creditors to send a periodic statement at least 14 days before the grace period [7] expires. While increasing numbers of consumers elect to receive their statements electronically, a significant number still receive paper statements and so the agencies believe this step is needed. The proposal would prohibit late fees or charges unless consumers are given a reasonable amount of time to pay. A specific time period would not be mandated, but "reasonable" would be determined from the perspective of the consumer and not the bank. The proposal would establish a safe harbor so that a statement mailed or delivered at least 21 days before the date the payment is due would be deemed reasonable.[8]

Currently, the great majority of community bank customers still receive periodic statements by regular mail, although increasing numbers are able to access account information online.[9] When remitting payments, between 70 and 80% of community bank

[6] Under this approach an "introductory rate" would be one type of "promotional rate."
[7] Although federal law does not mandate a grace period, the grace period is generally accepted as the time period that can elapse and let a consumer make payment without incurring finance charges. Consumers generally cannot take advantage of a grace period if they carry a balance from month-to-month. Another part of the proposal would change the use of the term.
[8] The intent is to allow 7 days for the statement to be mailed to the consumer, 7 days for the consumer to review and reconcile the statement, and 7 days for the payment to be mailed back.
[9] Slightly less than 1/3 regularly take advantage of this option.

customers also rely on regular mail. Between 15 and 20% regularly remit payments electronically but less than 10% use the telephone or other channels to make payments. Therefore, given the significant percentage of consumers continuing to use regular mail, proposing rules is appropriate.

ICBA agrees with the proposed provisions for payment due dates and also supports the proposed 21-day safe harbor. These provisions will give consumers ample time to receive and review their statements and then remit payments to avoid penalties. ICBA also believes the 21-day safe harbor is operationally feasible. Currently, most community banks mail statements within two to three days after the close of a cycle, but certainly no more than five days. Current systems are able to handle the proposed changes. Nearly 90% of community banks use a 25-day period after the statement closes before a penalty is triggered. Many community banks also allow an additional two to three days beyond that date before actually imposing a penalty If a late payment fee is imposed but a customer asks the bank to reverse the fee, where appropriate, community banks can and do re-credit the fee.

As an aside, since 21 days is close to the time period many issuers also use as the "grace period," it is likely issuers will elect to use the same period of time for both the grace period and the payment due date to simplify operations and avoid confusion.

Allocation of Payments (Section 23)

Another complaint frequently raised by consumers is how payments are allocated. For example, if a consumer opens an account with a balance transfer at a low interest rate but then makes purchases, he or she often fails to understand that the grace period is not available for those purchases because a grace period only applies when there is no outstanding balance.[10] Despite attempts to develop disclosures through consumer testing that clearly explain how this operates, consumers often fail to grasp that the existing balance on the account means that interest will be assessed from the date of a new purchase and that the grace period is not available. Consumers also frequently complain when payments are applied first to the balance with the lowest rate of interest.

To address these problems, the agencies propose: (1) when different APRs apply to an outstanding balance, lenders would have to use one of three methods for allocating payments; (2) if a promotional rate applies to any portion of the outstanding balance, lenders could not allocate payments to that balance before other balances in the account are paid; and (3) lenders could not require repayment of any portion of a promotional rate balance or a deferred interest balance in order to let the account-holder take advantage of a grace period otherwise available for purchases.

Where an account is carrying different balances at different APRs, the *general rule* would let banks use one of three approaches for allocating the amount that exceeds the minimum payment required for the account: (1) apply the entire amount to the balance with the *highest* APR; (2) allocate amounts equally to each balance; or (3)

[10] The balance transferred becomes the carried balance on the account that prevents the grace period from applying.

allocate the payment proportionally so that each portion bears the same ratio to the overall payment as that portion of the balance bears to the overall balance.

To comply with the proposed payment allocation methods and to take advantage of any flexibility the agencies believe is inherent in the proposal will be a major undertaking for service providers and community banks. ***Therefore, ICBA has serious reservations about the proposed methods for allocating payments.*** Although the proposal appears to offer some flexibility for community banks, operational limits will make it extremely difficult to apply most of these methodologies. For many community banks, adjusting to the proposal will depend on the abilities of their third-party processors to develop systems that can easily adapt to these changes, and ***ICBA strongly encourages the agencies to consult with major processors to determine how easily these changes can be adapted***. It is equally important to recognize that these restrictions are likely to impact the development and continuation of products and services to adapt to these restrictions. While ICBA is not aware of any particular product that these restrictions will affect, it is important for the agencies to be sensitive to the fact that changes like this will restrict how issuers design products going forward. And any such restrictions will sap some of the vitality out of the credit card market.

Current Community Bank Practices. Current systems used by community banks allow some limited flexibility in determining how payments are allocated. For example, systems will permit community banks to elect to allocate an incoming payment entirely to the balance that bears the highest rate of interest. However, in order to comply with the changes proposed, major software revisions will be necessary. Current systems are not capable of allocating payments using the proposed methodologies by allocating payments pro rata or equally. As a result, if the proposal is adopted without major revisions, current operational limits will leave community banks with one option: allocating the entire payment to the balance at the highest rate.

Minimum Payment. Another significant difficulty with the proposal from an operational perspective will be how to handle the minimum payment and deducting that from the remitted amount before allocating the payment. Current systems have no way to make this calculation and will require major re-writes to comply. Each one of the allocation methods allocates the payment *after* the minimum payment is deducted. The preamble and rule do not explain why the minimum payment calculation is taken into account, nor is there any explanation for how the minimum payment is to be applied to any outstanding balance. This additional step seems to be an unnecessary complication. ***ICBA recommends that the final rule be streamlined and that the minimum payment calculation be disregarded in determining how payments will be allocated.*** This will facilitate re-programming of systems and general compliance with how payments are allocated. Eliminating this provision will also make it much less confusing for consumers to understand and for banks and their processors to implement. And finally, it will clarify how the minimum payment is allocated since the proposal does not address that issue.

Alternate Allocation Methodologies

Under the proposal, a bank could use a method different from one of these three approaches to allocate payments but only if it is no less favorable to consumers than one of the three listed methods. Presumably, although not stated in the proposal, the bank would have to clearly demonstrate its alternative was equally favorable.

ICBA does not believe any community banks will elect this option. While we believe it is appropriate to include this option for any bank that chooses to elect an alternative payment allocation method, demonstrating that an alternative is equally favorable for consumers will be challenging, to say the least. ICBA recommends that the agencies incorporate some mechanism for banks to gain agency approval for an alternative allocation approach to minimize or eliminate questions if the bank does use one.

Accounts with Promotional Rate Balances or Deferred Interest Balances

If an account has a promotional rate balance or a deferred interest rate balance in effect, special rules would come into play. The proposed revisions are designed to ensure consumers can take advantage of the special rate. As a result, the proposal would prevent banks from applying any amount over the minimum payment due to the promotional rate balance or deferred interest rate balance until all other balances are fully paid.

Promotional rates and deferred interest are mechanisms that can be useful as a means to attract new customers. However, since this element of the proposal creates an unnecessary complication for how payments are allocated, ***ICBA opposes this element of the proposal***. It would be easier for consumers to understand and for bankers to comply with one system of allocating payments instead of introducing special qualifiers. If promotional rate or deferred interest balances are subject to the normal allocation systems, it will simplify operations and also ensure that these balances are not carried forward in perpetuity for some customers. This restriction and preventing payments from being allocated to these balances until other balances are paid in full is also likely to greatly discourage any issuer from offering such an option in the future. The risk of carrying a balance for an extended period at rates that could be lower than the issuer's cost of funds would make it impractical and unnecessarily risky.

The proposal would create one exception to this general rule. Generally, a deferred interest rate program is designed to let consumers avoid interest for a specific period. Some plans are not designed to fully amortize the balance before the period ends. Because failure to pay the principal in full by the end of the period can lead to penalties, including having to pay the full amount of interest that otherwise would have accrued, the proposal would allow payments to be allocated to the deferred interest rate balance during the last two billing cycles of the deferred interest period. ***ICBA agrees the exception is appropriate if the agencies do not make the preceding changes we have recommended.***

Grace Period

While not mandatory, grace periods generally let consumers make purchases and pay the balance on those purchases without interest. However, if another balance is

outstanding at the beginning of a statement cycle, the grace period is unavailable and interest begins accruing on the date of purchase. The proposal would change that for promotional rate balances and deferred interest rate programs. Under the proposal, if a lender offers a grace period for purchases, it could not require repayment of any promotional or deferred interest balance before a customer could take advantage of the grace period for new purchases. In other words, if the only outstanding balance at the beginning of the statement cycle is a promotional rate balance or deferred interest rate balance, then the bank must let the customer take advantage of the grace period for new purchases to the same extent as any other customer.

ICBA seriously questions the benefits of this element of the proposal and believes it would actually do a disservice to consumers. While the intention is to let consumers take advantage of both a promotional rate *and* a grace period offered to others, this step may actually help eliminate or greatly diminish the existence of promotional rates. If special rates for balance transfers or promotional rates are eliminated, that will be a disservice for consumers. Issuers do not benefit from the balance transfer and primarily look to new purchase activity for earnings. If the bank has to minimize the earnings on new activity as long as any promotional rate balance is outstanding, that will encourage issuers to discourage or eliminate promotional rate balances. In addition, it is not entirely clear that systems can be configured to distinguish promotional rate balances and other balances. Therefore, operational challenges alone may make it difficult if not impossible for issuers to continue offering these promotions.

Increasing the Rate on an Outstanding Balance (Section 24)

Another complaint from consumers and members of Congress is that even though a penalty rate might apply to a consumer who failed to live up to the terms of the account agreement, it is still unfair to apply that increased rate to existing balances. Since those transactions occurred when the consumer believed the rate in effect at the time of the transaction would be the applicable rate, a bank should not be allowed to retroactively increase the rate on those balances.

Currently, approximately 60% of community banks use some type of re-pricing mechanism for delinquent accounts, affecting between 10 to 15% of their consumer credit card portfolio at any given time. Most community banks base these rate increases on their direct experience with the customer's performance on the account, either through payment history or delinquency, although a small percentage do increase the interest rate to reflect the customer's risk following an account review and discovery of changes to the customer's overall credit score. And, while systems permit "risk" re-pricing, it is not currently extensively used by community banks, with perhaps 5% of community banks electing to apply an automatic risk re-pricing. However, the ability to increase the rate is an important safety-and-soundness tool useful for managing risk.

While ICBA is not aware of any community banks that offer a card that guarantees there will be no rate increase on the outstanding balance, many community banks do offer their customers the opportunity to opt out from rate increases. For consumers who elect this option, the account balance is frozen and the account closed to

future transactions. The existing balance is then amortized at the current rate. For customers who elect to continue using the account at the increased rate, systems can permit the existing rate to apply to the outstanding balance and the new rate to apply only to new transactions going forward. However, for simplicity and for ease of consumer understanding, most community banks elect to apply a single rate to the outstanding balance and new transactions.

The 2007 proposal, if adopted, would expand the advance-notice timeframe before a rate increase from 15 days to 45 days and also expand the notice requirement to cover defaults or delinquencies on the account. However, as a result of comments on the 2007 proposal, the agencies question whether disclosure alone is sufficient. For example, it is suggested that consumers lack control over the circumstances that cause a rate increase or that an increase is caused by events separate from the credit card account relationship. To address these concerns, this proposal would greatly restrict when issuers could increase the rate on an existing balance.[11]

ICBA disagrees that this is appropriate and opposes this provision. While the intent is understandable, compliance with this restriction will be difficult operationally. Essentially, many if not all issuers will be compelled to convert outstanding balances into separate term loans amortized in accordance with the restrictions. The proposed rules do not offer any guidance, though, on how incoming payments will be allocated to the frozen outstanding balance. This will add additional regulatory burdens that must be addressed.

If this restriction is imposed, then community banks will investigate other mechanisms to compensate for the commensurate increase in risk, both for an individual customer and for the overall credit card portfolio. In lieu of increasing the rate on an individual consumer's outstanding balance, credit card issuers would: likely rely on higher fees and penalties for late payments or exceeding the limit on the account; investigate adopting other fees; adopt an annual fee; reduce the amount of credit available; require collateral of some type to secure the account; or encourage customers to move to prepaid debit cards. What seems most likely, though, if this restriction is imposed is that rates will be increased across the board for all consumers to compensate for the added risk. Banks use risk-based pricing – something that the agencies have been promoting and encouraging – to extend the best rates to the least risky consumers. Risk-based pricing also lets issuers offer credit to higher-risk consumers. Removing the ability to reprice as the borrower becomes increasingly risky will cause higher rates for all consumers and make it more difficult for marginal borrowers to continue to have access to credit.

Another possible outcome if the final rule restricts the ability of issuers to reprice to reflect a change in the risk profile of a consumer is that the issuer will be compelled to

[11] The agencies did consider the option of allowing the lender to notify the customer and then giving the customer an opportunity to opt out of the increased rate. Essentially, this would convert the existing balance on the open-end credit card into an installment loan. However, the agencies believe that such an approach would increase costs and burdens for both consumers and lenders.

close the account. One of the fundamental mistakes that some make when analyzing existing practices is assuming that changing one variable means all others remain equal. However, in the real world that is not the case. Eliminating the ability of an issuer to reprice on outstanding balances does not mean that the account must remain open. Issuers may very well conclude that, from a safety and soundness perspective, instead of re-pricing or increasing the rate to adjust for a changed risk profile, the better solution would be to terminate the account relationship or simply convert the outstanding balance to a term loan. This is not beneficial for consumers, especially given current market conditions and the state of the economy.

When the Balance Could Increase. Under the proposal, the outstanding balance would be defined as the amount due on the credit card 14 days *after* the lender issues a rate-increase notice.[12] ***ICBA does not object to the 14-day cushion for rate increases.*** While we oppose restricting issuers from increasing the rate on the outstanding balance, if the proposal moves forward, then ICBA agrees that using the balance 14 days *after* the rate-increase notice is provided is acceptable. It seems reasonable and gives the customer time to take appropriate steps. ICBA also does not believe this element will present significant operational challenges. However, ICBA is concerned that this could allow unscrupulous customers to run up the balance before the rate increase takes effect. Issuers will need the flexibility to take steps to maintain safety and soundness if this is the case. Therefore, the final commentary or guidelines should allow issuers to close accounts or place other restrictions on consumers who take unfair advantage of this 14-day window. ICBA also believes this added time could be confusing to many consumers and therefore ***ICBA strongly encourages the agencies to develop educational material for consumers using consumer testing*** to help consumers understand how this operates. It would also be appropriate for any model disclosures to incorporate this element, so that any notice would clearly state the date on which the increased rate takes effect, i.e., "your interest rate will take effect on September 18, 2008."

Exceptions. The agencies propose three exceptions to this restriction. First, if the rate is based on an index outside the lender's control, the APR on outstanding balances could change when the index changes. However, the rate could change only when the index changes and not by changing how the index is applied. Second, if a promotional rate expires or is lost for some reason specified in the account agreement, the rate could increase. In that case, though, the lender could only increase the rate to the rate that would otherwise apply (the standard rate) and not to the penalty rate.[13] Third, an increase could apply to an outstanding balance if the minimum payment due on the account has not been received within 30 days after the due date.

If the agencies proceed with the proposed restrictions on rate increases for outstanding balances, then ICBA agrees these proposed exceptions to the restrictions

---

[12] This 14 day delay is designed to ensure that the notice is received by consumers.

[13] For example, if a credit card has an introductory rate of 10%, a standard rate of 15% that would apply after the introductory period expires, but a 20% penalty default rate, when a consumer does something that causes the termination of the 10% rate, the bank could only increase the rate to 15% and not 20%.

are appropriate. It especially makes sense to carve out a provision for delinquent accounts.

Paying Any Outstanding Balance. The proposal would address how a lender would treat *outstanding balances following a rate increase.* First, the bank would have to let the consumer pay the outstanding balance at the existing rate using one of the following methods (or an alternative that is no less beneficial to the consumer): (a) amortize the balance over no less than five years starting on the date the increased APR took effect; or (b) requiring a minimum periodic payment that is no more than twice the percentage of the balance required under the minimum payment calculation used before the increase.[14]

ICBA does not object to this provision for paying the outstanding balance following a rate increase. However, ICBA is concerned that five years may be too long under the first option and believes community banks should be able to use a shorter period, especially if the balance is very small. Requiring a five-year amortization on a balance of $200, for instance, would be unduly and unnecessarily burdensome for all concerned. ***ICBA recommends permitting the bank and the customer to agree on a shorter period, not to exceed five years.***

The second option, based on the minimum payment calculation, will be cumbersome and likely confusing to consumers. ICBA believes greater explanation about how this will apply in practice may be necessary and anticipates that additional questions are likely to arise once community banks attempt to implement this provision. In fact, both methods will be difficult to explain to consumers and ***ICBA strongly encourages the agencies to develop model disclosures that can be easily explained to and grasped by the average consumer***. The agencies also should test this model disclosure with consumer focus groups.

Community banks are likely to use both models to amortize payments, depending on the bank's particular systems and circumstances, but the second option is likely to be easier to use from a systems perspective as well as preferable for lower balances.

The proposal is silent on how bankers will allocate this portion if an account continues after the rate increase and how it will be treated in coordination with payments allocated to new balances for purchase and other transactions at the higher rate. ***ICBA recommends the final rules explain how the outstanding balance comes into play when allocating payments to different balances***. Any proposed system for calculating this should be issued for additional public comment before it is finalized.

Finally, where an increased rate triggers this provision, the lender would be barred from charging any fee based solely on the outstanding balance. ***ICBA agrees this is appropriate.***

---

[14] For example, if the minimum payment before the increase includes 1% of the outstanding balance, after the changes the required minimum periodic payment could increase to 2% of the outstanding balance.

Credit Card Holds (Section 25)

Yet another concern that has been raised over current credit card practices involves holds on accounts. From time to time, merchants place a hold on a credit card to ensure the amount is available when the transaction settles. For example, when a consumer checks into a hotel for a three night stay at $250 per night and plans to pay with a credit card, the hotel might place a $750 hold on the account. Similarly, service stations might place a $50 to $70 hold on an account when a consumer fills the tank with gas at a self-service station. It may be several days before the transaction finally settles, the final amount may not be as large as the hold, or a merchant might use different codes so that the hold and the final transaction do not immediately match. Meanwhile, a consumer might unknowingly exceed the available balance on the card.

Current Community Bank Overlimit Fee Practices. Current systems will let a bank impose either a single overlimit fee during a statement cycle or impose a separate fee for each transaction that causes the account to exceed the credit limit. Most community banks only assess the overlimit fee one time during a given statement cycle. However, existing community bank processing systems allow for varying fees based on different parameters, such as varying the overlimit fee with the amount the credit limit has been exceeded. Current processing systems also let banks continue to assess an overlimit fee in subsequent credit cycles where the balance continues to exceed the limit even if there are no new transactions, although most community banks restrict the number of times this fee will be imposed. For example, ICBA's credit card subsidiary limits this to a maximum of three statement cycles.

Holds and the Credit Limit. The agencies believe it is inherently unfair to charge a consumer where the credit line is exceeded solely due to an outstanding hold on the card. The proposal would prohibit such charges unless the actual transaction amount otherwise would have exceeded the credit limit.

ICBA agrees with this restriction in concept; however, it will be difficult to implement operationally. For example, merchants may put an authorization through twice but the bank has no way to know for certain if that was an error or intentional on the part of the merchant. In addition, how merchants process transactions can make it extremely difficult for banks to match transactions to reconcile, and we understand that many banks simply release the hold after 48 to 72 hours regardless of whether they have been able to match transactions on the premise that there is no further risk mandating the hold.[15]

ICBA is concerned that the proposals regarding holds could create many unintended consequences and believes action should be deferred until the agencies better understand the process. For example, one of the issues discussed at the Federal Reserve's Consumer Advisory Council meeting in June was a mechanism that would explain holds to consumers and better inform them when a hold has been applied. ***ICBA urges the agencies to develop materials that can easily and clearly explain holds to the***

[15] This was discussed in depth during the Federal Reserve's Consumer Advisory Council meeting on June 19, 2008.

average consumer. Since holds originate at the merchant level, merchants need to be required to provide the information to consumers *at the time the hold is placed.* Moreover, clear understanding of the hold process and the risks it is intended to address need to be better articulated and understood. At present, the understanding of holds, what risks they are designed to address, how they operate, where they originate, what impact they have and how to best explain them to consumers needs much further investigation and study before rules are imposed.

ICBA agrees that an exception for when the actual transaction would exceed the limit is appropriate. However, if a hold is in place, the proposal is silent on how subsequent transactions would be handled. For example, if there is a hold for one transaction and another transaction is processed that would exceed the balance with or without the hold, should that second transaction be processed, held, or treated as over-the-limit. In short, the proposal creates more problems than it solves. Therefore, ICBA urges the agencies to defer action on holds until the process is better understood.

Unfair Balance Computation Methods (Section 26)

A great deal of attention has been paid to "double cycle" billing, a process that was one of the initial factors that caused Congress to become interested in unfair credit card practices. Generally, the agencies propose to ban any finance charges based on balances that precede the current billing cycle. While this billing method does not impact consumers who carry a balance from month to month or consumers who pay their balance in full each month, it does affect consumers who pay in full one month and then carry a balance the following month. There would be two exceptions to this prohibition: (1) lenders could charge deferred interest even though it accrued over multiple billing cycles, and (2) lenders could post finance charges from a disputed transaction after the dispute was resolved.

ICBA supports a ban on "double cycle" billing. ICBA also concurs with the two exceptions to the ban. However, since non-depository institutions will be permitted to continue to use the "double cycle" billing method, which is why the Federal Reserve proposes maintaining an explanation of the method in its model disclosures under the separate Regulation Z proposal, ***ICBA recommends the rule and disclosures should clearly articulate that the ban is limited to depository institutions.*** That will avoid confusion and identify that the ban is not a complete one. Unfortunately, as we have seen in the mortgage markets recently, the average consumer does not distinguish depository institutions from one another much less distinguish non-depositories from depositories. Therefore, in instances like this where the agencies are creating a distinction based on charter or supervision, the rule should make that clear to everyone.

Subprime Accounts (Section 27)

When the Federal Reserve proposed the new credit card disclosures in 2007, ICBA supported a new requirement to disclose the amount of credit available (in addition to the credit limit) for cards where fees and charges at account opening exceed 25% of the available credit. Generally, these programs are offered to consumers with impaired or

limited credit histories. Since the agencies are concerned that disclosures may not protect consumers enough, especially where sales practices may be deceptive, this proposal would go further.

First, lenders would be prohibited from charging security deposits and fees for the first 12 months after the account is opened if those amounts in the aggregate constitute the majority of the credit available. Second, lenders would be barred from charging security deposits and fees during the first billing cycle if those charges exceed 25% of the available credit. If security fees and deposits exceed 25% of the credit line, but are less than the majority of the credit limit, the lender could not charge more than 25% of the amount in the first billing cycle. The remaining fees and charges would have to be amortized equally over the next 11 monthly cycles.[16]

ICBA supports this proposed action. As a general proposition, community banks do not offer these types of accounts. ICBA also agrees these accounts should be carefully controlled. At the same time, ICBA believes that the restrictions for assessing fees and charges over 25% but less than half of the initially available credit will be operationally challenging to implement.

When discussing accounts such as these that can be and have been abused, the agencies also need to be mindful that similar accounts can be used as tools for consumers with blemished credit histories or problem credit records to let them access credit. While we agree restrictions are necessary and that the agencies are taking the proper steps here, ***ICBA also encourages the agencies to ensure that legitimate providers can continue to develop products and services for risky consumers that can be offered fairly without abusive terms***. The goal is to protect consumers but also to arm them with information, tools and resources that allow them to be responsible users of financial products and services. When an agency cuts off a product or service such as this because it is deemed potentially abusive, it is equally important not to cut off access to legitimate service providers. The need or demand will not disappear and the agencies should avoid steps that simply create a fertile environment for less-regulated and lightly-supervised (or non-supervised) entities to step into the breach. By pushing the market away from depository institutions, as happened with mortgage markets, it is possible to ultimately create a negative environment that can cause greater harm for marginal consumers.

Firm Offers of Credit (Section 28)

The agencies are also concerned about advertising and solicitations that involve multiple rates or credit limits. Generally, these occur where a consumer is offered credit but the final rate and actual credit limit depend on assessment of the consumer's current financial condition. The proposal would require a new disclosure to be sure consumers clearly understand they might not get the lowest rate or the highest available balance. This new disclosure would have to be clear and conspicuous, although a bank could meet

[16] Put another way, a creditor cannot assess fees and other charges that constitute more than 50% of the credit line for the first year. If the fees and charges are more than 25% but less than 50%, the first 25% can be assessed in the first month and the rest has to be spread equally over the following 11 months.

this standard by using a typeface and type size that are easy to read and making the disclosure in boldface or other means that calls attention to the nature and significance of the information. To help banks make the disclosure the proposal includes model language: *"If you are approved for credit, your annual percentage rate and/or credit limit will depend on your credit history, income and debts."*

ICBA fully supports this requirement and the model disclosure. The language will minimize any potential misunderstanding by consumers in a clear, simple and straightforward way. ICBA also supports the use of model language as a safe harbor for community banks that elect to follow the model. While it is not guaranteed that consumers will read or pay attention to the information, providing it as a part of advertising and solicitations is worthwhile.

Overdraft Services

The next major component of the proposed new UDAP rule would add a new Subpart D to address concerns about the operation of overdraft protection programs. Historically, banks have allowed customers to overdraw their accounts as a courtesy. Recognizing that payment of overdrafts benefits consumers, the Federal Reserve has exempted these transactions from Regulation Z for nearly 40 years.

For many years community banks determined whether to clear an overdraft on an *ad hoc* basis. Recently, though, banks have taken advantage of new technologies and have automated the process. Typically, these automated programs let consumers who meet specific parameters overdraw an account up to a pre-set limit. While consumer advocates complain these programs are a trap for the unwary, especially the elderly and students, banks point out that the programs provide a service most consumers appreciate. Moreover, banks stress that automation reduces costs and ensures consistent treatment.[17]

While individual programs vary, there are certain common characteristics associated with overdraft protection services:[18]

- Consumers are covered once they satisfy the bank's pre-set criteria;
- Banks tend to periodically review individual accounts to ensure the privilege is not being abused;
- Consumers are informed that coverage of an overdraft is not automatic but at the bank's discretion;

---

[17] It is worth noting that earlier this year the Government Accountability Office (GAO) reported that community banks tended to charge $4 to $5 *less* than large banks for an overdraft or insufficient funds. *Bank Fees: Federal Banking Regulators Could Better Insure That Consumer Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts,* GAO Report 008-281, January 2008.

[18] As noted previously, these programs do not include and the proposal would not apply to lines of credit attached to an account that can be used to cover overdrafts nor would it apply to balance transfer programs where funds are moved from a different account to cover an overdraft.

- The service extends to non-check transactions such as ATM withdrawals, automated clearing house (ACH) transactions, debit card transactions at point-of-sale, pre-authorized automatic debits from an account, telephone-initiated funds transfers and online banking transactions; and
- A flat fee is charged[19] each time an overdraft is paid and a daily fee may apply each day the overdraft is outstanding.

Where banks tend to differ most often is the extent to which customers are informed about the program.

Interagency guidance on overdraft protection programs was issued in February 2005 and the Federal Reserve issued new rules under the Truth-in-Savings Act and Regulation DD shortly afterwards. Community banks have updated procedures and processes to comply with these changes. However, the agencies continue to be concerned about how these programs are marketed, disclosed and implemented. Therefore, they now propose additional protections for consumers.

Current Community Bank Practices[20]

Not all community banks currently offer an overdraft protection service. Those that offer the service, though, report that do so as a service for customers. They also report that consumers appreciate the service. Generally, when a community bank offers the service, they use software provided by a third-party provider. Many also offer customers the opportunity to opt out from the service, although they report few customers do opt out.[21]

Right to Opt Out

In the February 2005 interagency guidance, the regulators identified consumer consent to overdraft protection as an optional best practice. Because the agencies are still concerned about whether consumers are properly informed about consumer overdraft protection services, this proposal would make it mandatory for banks to notify customers about the existence of the service and also require banks to give customers an opportunity to opt out of the program. In part, the proposal was prompted by media reports of large overdraft fees on small-dollar point-of-sale transactions, especially instances where two or three cups of coffee purchased over a weekend cause substantial overdraft fees.

---

[19] Generally, the fee for covering an overdraft under one of these programs is equivalent and often identical to the fee for a returned check.

[20] More detailed information on current community bank practices for overdraft protection service is included in an extensive ICBA comment letter filed July 25, 2008, on changes proposed in a companion proposal under Federal Reserve Regulation DD, Truth-in-Savings. The letter is posted on ICBA's website, www.icba.org.

[21] One banker reported that the only segment of customers that elects to opt out is parents of college students who set up debit card accounts for children away at school. When transactions are rejected due to insufficient funds, it compels the students to contact the parents.

Under the proposal, a consumer would have to be given a clear and conspicuous notice about the program and the ability to opt-out, a reasonable time to opt out from coverage and then not opt out before the bank could charge a fee for covering an overdraft. The right to opt out would apply to all forms of payment where an overdraft could occur, including checks, telephone transfers, ACH debits, online bank transactions, ATM transactions and POS debits. Once exercised, the opt-out would remain in effect unless subsequently revoked in writing by the consumer.

ICBA agrees it is appropriate to provide consumers with a simple disclosure and an opportunity to opt out before applying the program to a consumer's account. Many community banks around the country already provide this option for their customers, although they also report few customers actually opt out. ICBA also agrees that it will not be difficult to implement a simple opt-out that applies to all transactions on an account.

However, that being said, the proposal raises a number of questions that also need to be addressed. For example, what is considered a "reasonable" time to allow a customer to opt out? During the interim, must the bank reject any transaction that would otherwise overdraw the account? For a joint account, can one party bind all account-holders or do all account-holders have to agree to opt out? And must a consumer opt out for each account or would an opt-out apply to all accounts that customer has with the institution? These elements need to be addressed in the final rules after additional public feedback.

Once a customer has opted out, ICBA believes banks should be able to restrict the ability of a customer to opt back in. It would not be fair to the bank to let customers constantly change their mind and opt in one day and opt out the next and then back in on day three. Once a customer has opted out, the bank should be able to restrict the ability to opt back in until a certain period of time – at the discretion of the bank – has elapsed or perhaps assess a nominal fee before letting the customer opt back in.

Partial Opt-Out

In addition to the general right to opt out from an overdraft protection service, banks would have to provide a second level of opt-out for every consumer. Under this category, consumers would be given a more limited opt out that applies only to overdraft protection at ATMs and POS debit card transactions. Even though some software programs may not currently be capable of permitting this two-tiered opt out, the agencies believe that the benefit to consumers will outweigh any costs needed to update systems and software programs to comply.

ICBA strongly opposes this partial opt-out and urges the agencies to withdraw this element of the proposal. Fundamentally, it is not operationally feasible for most banks to apply a partial opt-out. For many community banks such technology is non-existent. Therefore, if the final rule mandates a partial opt-out, it becomes an effective barrier that will prevent many community banks from continuing to offer overdraft protection service at all. It is important that the agencies also recognize that a partial opt-

out for debit cards cannot be limited to point-of-sale transactions but would also apply to recurring payments and online transactions. While a customer might believe that opting out would avoid a $30 fee for a $2 cup of coffee, he or she would be unpleasantly surprised when cable service is cut-off for lack of payment because the charge was set up using a debit card or recurring payment and the transaction would have overdrawn the account and was rejected.

While many community banks offer alternatives such as overdraft lines of credit or balance transfer programs, those alternatives are not universal. And even where a community bank offers alternative means for a consumer to cover an overdraft, not all consumers will be eligible or will apply for them. As a result, the agencies should anticipate that the partial opt-out will, at a minimum, produce an increase in the level of rejected transactions and returned checks. When a check is returned, the customer stills incurs a fee – along with the numerous other problems associated with a bounced check. In addition to the bank fee, a consumer will likely be charged a separate fee by the merchant, have to resolve the payment to the merchant, possibly have a negative mark on a credit report or check verification service, and may be compelled to remit future payments to that merchant using only cash, cashier's checks or money orders. And, there is the embarrassment associated with bouncing a check.

Notice

The opt-out notice would have to be provided before the bank could charge a fee for overdraft coverage. In addition, the notice would have to be provided at least once during or for each periodic statement cycle when an overdraft fee is posted to the customer's account. For the latter notice, a bank could send a separate notice in the mail or include it on the customer's periodic statement.

ICBA strongly opposes the requirement to continually notify the customer. This proposed requirement will produce information overload for consumers and have the inverse impact of causing consumers to ignore the disclosure. As one community banker aptly commented, "having to provide the notice every time the customer overdraws seems to be overkill." Requiring a full opt-out notice every time a consumer overdraws the account is redundant and unnecessarily costly.

Under the Regulation DD proposal, the Federal Reserve would require all depository institutions that offer overdraft protection services to include four additional disclosures on the periodic statement for an account: overdraft fees for the cycle, returned check fees for the cycle, aggregated overdraft fees year-to-date and returned check fees year-to-date. That information should have the desired effect of making consumers aware of the impact from overdrawing their accounts and encouraging them to manage their accounts responsibly. A simple one-line clear and conspicuous disclosure on the statement to the effect that "you have the right to opt out from overdraft protection coverage" should be sufficient without having to provide the full detailed notice. Then, sending the full opt-out notice no more than annually – if that frequently – would be more than enough and would also make it more likely consumers would pay attention to the notice.

If the agencies mandate an additional full opt-out notice each cycle that there is an overdraft, ***ICBA encourages the agencies to permit banks the option of including a separate sheet with the statement instead of mandating a disclosure* on *the statement.*** Allowing banks to include a disclosure notice with the statement will simplify procedures, although either option will be operationally challenging and require reprogramming of software to comply. Placing a complete opt-out notice on the statement will limit the amount of information that can be included and so it would be easier to include a separate notice with the statement. In addition, allowing banks to include a separate disclosure with the statement would let them use the same notice at account opening and for subsequent reminders.

Exceptions

The proposal allows limited exceptions where a bank could still charge for an overdraft despite the preceding proposed restrictions. First, a bank could charge a fee for overdraft coverage involving a debit card transaction if the amount of the purchase exceeds the amount that was pre-authorized. Second, an overdraft fee would be permitted where a merchant or other payee submits a debit card transaction by paper that was not pre-authorized. In addition, since the agencies are concerned about possible unintended consequences, they are considering whether they should add other exceptions, such as one for banks that use batch processing to settle transactions.

ICBA agrees that these two exceptions are useful. In both instances, the transactions causing the overdraft are due to elements outside the bank's control. These are instances where the merchant bears a certain level of responsibility. Since the account-holding bank cannot control what happens, these exceptions are appropriate. ***ICBA also recommends an additional exception for banks using positive file processing.*** While community banks are moving towards real-time processing, there are still many community banks that authorize transactions using positive files reflecting account balances as of the previous night.

Debit Holds

A debit hold occurs when a consumer uses a debit card for a transaction but the final amount is unknown when the transaction was initially authorized.[22] Typically, the hold remains in place until the transaction settles. Assessing an overdraft fee while the hold is in place would be considered an unfair practice and prohibited by the proposal. This prohibition would not apply where there were insufficient funds in the account to cover the transaction. The prohibition applies only where the hold itself caused the overdraft.

ICBA agrees with the concept but believes that it will be virtually impossible to apply and therefore opposes this restriction. As noted above with respect to credit cards, it is not always possible to match transactions because of the way merchants process

[22] The most common example is a consumer paying for a meal in a restaurant where the amount of any gratuity is unknown when the transaction is authorized.

accounts. First and foremost, it is not the bank that puts the hold in place and it is not the bank that benefits from the hold. As a result, many banks simply lift the hold after 48 to 72 hours because there is no way to reconcile the two. In other instances, an identical hold may come through more than once and the bank has no way of knowing if that was an error or intentional. And, if a hold is in place for one pending transaction, that raises the question of how the bank can handle any subsequent transactions, including recurring pre-authorized debits. Fundamentally, ICBA believes that the proposed restrictions on holds will be so difficult to follow that many banks will opt out of using the account holds. This then creates new risks that will have to be addressed in other ways, including possibly closing accounts.

Order for Processing Transactions

When discussing overdraft protection services, the issue of which order banks should process transactions is often raised. It has long been established under the Uniform Commercial Code that "items may be accepted, paid, certified, or charged to the indicated account of [a bank's] customer in any order."[23] Whenever the order in which items have been processed has been challenged, courts across the nation have affirmed that this is completely within the bank's right to determine.

Banks have often pointed out that processing the largest items first is to the benefit of consumers, since those transactions are likely to be payment for mortgages, rent, insurance or other significant items. Consumer activists, though, contend that it would be preferable to cover the smaller items first since that means that more transactions will clear and settle before the potential for an overdraft might occur, thereby minimizing overdraft fees. While it may be a good practice to inform consumers about how banks intend to clear transactions, mandating or restricting the right of banks to do so would be a nightmare that would upset the entire payment system. For example, many banks clear transactions during the course of the day as they are received. As real-time processing increases – to the benefit of all payment system participants and the overall economy – the likelihood that items will be cleared in the order received increases. Were banks suddenly required to process largest items first, for example, it would necessitate holding all transactions until a cut-off point to determine the order in which they should be processed. That alone would substantially diminish the efficiency of the entire payment system.

If, however, banks were required to process items in a specific order, there is no way under current processing software systems to allow individual customers to select different methods. All customers would have to be subject to the same method, whether random, in ascending order or descending order. Current systems are simply not capable of allowing each consumer to elect a different method – and to do otherwise would be extremely burdensome and costly.

[23] UCC Section 4-303(b).

If one accepts the premise that it is better to process smaller items first to diminish the level of or potential for overdrafts, that increases the chance that larger items will exceed the amount permitted for overdraft and increases the likelihood that larger transactions – those for rent, mortgage, insurance and so forth – will be rejected with greater consequences and inconvenience to the customer. In short, the current system of allowing individual community banks the flexibility to determine the order for processing transactions which has long been codified in the Uniform Commercial Code should not be changed barring any clear and significant benefit. There has been no showing that there would be such a benefit to making the change. In fact, the arguments against changing that far outweigh any benefits that might accrue.

Effective Date

Finally, the agencies are considering the amount of time banks will need to adjust systems and procedures to comply with the new requirements and with any new rules that result from this and the two related proposals under Regulation Z (TILA) and Regulation DD (TISA). Currently, they are considering whether a one-year period is sufficient.

Generally, ICBA believes that one year* may *be sufficient time for community banks to comply with any proposed changes. However, because these changes are extensive and because there are other changes that banks must implement simultaneously, ICBA strongly urges the agencies against considering any shorter timeframe. Since many of these changes will require major system changes, ICBA also strongly recommends the agencies consult with major third-party software providers and vendors to ensure they can make the appropriate changes in time for banks to implement them. And finally, since there are related changes under two other rules that are companions to these changes, ***ICBA strongly urges the agencies to have one single effective date*** to allow banks to coordinate and apply the changes at once. This will ease some of the burden and will also help avoid confusion for customers.

Conclusion

ICBA agrees with the agencies that protecting consumers is important. However, ICBA also is concerned that the "protections" that have been advocated by some may actually do more harm than good. Restrictions that become a costly barrier to serving customers – especially restrictions that do not apply universally but are limited to depository institutions – do not protect consumers. Instead, since the demands and needs still exist, these restrictions drive consumers away from banks, thrifts and credit unions. To meet their needs, consumers turn to less heavily regulated and less closely supervised providers, including payday lenders, check cashers and others where applications are likely to be less carefully scrutinized, any disclosures will be less informative, and upfront costs and fees will be less. Similar "protections" for mortgages imposed on depository institutions encouraged non-depository subprime mortgage providers to take advantage of the demand for real estate credit. The gravitation of consumers to less regulated and lightly supervised providers helped cause the mortgage problems facing the

economy today. It would be unfortunate to take steps that create a similar environment in other areas, especially since that will wreck havoc on the least sophisticated and most marginal consumers.

ICBA is especially concerned that using UDAP to develop rules that will apply only to depositories will create an environment for expanded litigation and will discourage many community banks from continuing to offer financial products and services that most customers value and welcome. Perhaps more important, if these changes are adopted as proposed, elimination of providers from the market and reduced access to credit for consumers, especially marginal consumers, will be the likely result.

One of the hallmarks of community banks is the trust and respect that they have earned from their customers. Community banks work very diligently to maintain that trust. New rules that pile onto regulatory burdens and hamper the ability of community banks to continue offering existing financial products and services are not, in the long run, beneficial for anyone. ICBA looks forward to continuing to work with the agencies to develop rules that can be easily understood, that equip consumers with the necessary tools and resources to responsibly manage their finances and that ensure community banks can continue to offer financial products and services that our customers welcome and need.

If you have any questions or need additional information, please contact the undersigned by telephone at 202-659-8111 or by e-mail at robert.rowe@icba.org. Thank you for the opportunity to comment.

Sincerely,

Robert G. Rowe, III

Robert G. Rowe, III
Senior Regulatory Counsel