



1120 Connecticut Avenue, NW
Washington, DC 20036

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Nessa Feddis
Vice President &
Senior Counsel
Center for Regulatory
Compliance
Phone: 202-663-5433
Fax: 202-828-5052
nfeddis@aba.com

By electronic delivery

27 March 2009

Ms. Jennifer J. Johnson
Secretary
Federal Reserve Board
20th and C Streets, NW
Washington, D.C. 20051

Re: **Docket Number R-01343**
Proposed changes to Regulation E
Electronic Fund Transfer Act
74 Federal Register 28866

Dear Ms. Johnson,

The American Bankers Association appreciates the opportunity to comment on the Federal Reserve Board's ("Board") proposed amendments to Regulation E, which implements the Electronic Fund Transfer Act ("EFTA"), published January 29, 2009 in the *Federal Register*. The proposal would limit the ability of a financial institution to assess an overdraft fee for paying ATM withdrawals and one-time debit card transactions that overdraw a customer's account, unless the customer is given the notice of a the right to opt out of the payment of overdrafts and the customer does not opt out. As an alternative approach, the proposal would prohibit imposition of overdraft fees unless the customer has affirmatively consented or "opted in" to have such overdrafts paid. In addition, the proposal would prohibit financial institutions from assessing an overdraft fee if the overdraft would not have occurred but for a debit hold placed on funds in the customer's account that exceeds the actual amount of the transaction.

The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members - the majority of which are banks with less than \$125 million in assets -represent over 95 percent of the industry's \$13.3 trillion in assets and employ over 2 million men and women.

We agree with the Board that Regulation E is the appropriate regulation to address overdraft accommodation programs, coupled with the recently finalized amendments to Regulation DD (Truth in Savings Act) on overdraft disclosures. To ensure that customers continue to have choices and access to a service the Board's testing showed customers expect and value, ABA recommends that the final rule permit banks latitude when providing an election not to cover debit card transactions in their overdraft accommodation programs—permitting either an “all-in” account level choice or a partial election limited to debit card transactions that properly recognizes how they are used and processed given operational limitations. In addition ABA urges the Board to adopt a rule based on a customer's right to opt out of overdraft accommodation programs and for banks to satisfy that option by offering alternative accounts that are reasonable or customary.

The final rule should also allow reasonable variations in terms and conditions depending on whether the customer has elected or declined to accept overdraft accommodation services. The rule should permit the assessment of overdraft fees when a customer (who has declined overdraft accommodation) overdraws an account by a transaction that the bank did not approve. Finally, the Board should adopt the prohibition against assessing an overdraft fee if the overdraft would not have occurred but for a hold related to a debit card transaction but only if the rule provides that the merchant may determine the amount of the transaction within a “reasonable time.” However, “reasonable time” should be considered the end of the processing day and the regulation should require merchants to submit transactions by the end of the processing day of the authorization.

I. General overview.

The banking industry has always exercised discretion to cover overdrafts for certain customers. Today banks have developed safe and sound programs that extend this discretionary accommodation to the vast majority of our customers. Bank overdraft accommodation practices are successful because they provide desirable back-up for customer payment decisions, and they are sustainable because people want the bank to recognize that when they inadvertently overdraw their account they can be trusted to make it right and are prepared to pay for the bank's accommodation.

Today's “bounce protection” or overdraft accommodation programs are basically the latest, customer-driven innovation of this traditional practice. The primary difference is that many of the more recent overdraft protection practices rely on **automated** systems. The advantages of the automation of the historical practice of paying overdrafts on a discretionary basis are that it reduces costs associated with case-by-case assessment and manual intervention and promotes consistent treatment of customers.

In most cases, the customer initiating a payment transaction wants to complete it and appreciates the bank paying it, even if there are insufficient funds. Indeed, ABA's recent survey found that of the 20 percent of consumers who had paid an overdraft fee in the last year, 85 percent were glad their bank did so.¹ The Center For Responsible Lending in its January 2007 survey showed a similar attitude among consumers: Over 92 percent, when asked, said they would like the bank to pay it and were willing to pay something for it.²

This favorable customer sentiment was also reflected in the Federal Reserve Board staff's own consumer testing.³ Most of the participants in the Board's own testing were not surprised banks offered overdraft protection, understood that they would be automatically enrolled, and understood the consequences of opting out. Further, participants generally indicated that the overdraft coverage described in the disclosures was a positive feature for those who need it or for particularly important transactions.

Although consumers interviewed by the Board have indicated a split in opinion with respect to their desire for overdraft accommodation of ATM and so-called "one-time debit card transactions," this test result was based on a failure to inform consumers about the technical constraints that prevent debit card purchases from being faithfully distinguished from one-time debit card bill payments let alone recurring debit card based bill payment transactions. Policy-makers or consumer groups who focus on the apocryphal cup-of-coffee-overdraft inappropriately discount the use of debit card for bill payment and overreact to the amount of an overdraft fee for a small purchase—rather than appreciate that it is fundamentally a failure of customers to manage their account balance that incurs the fee. The cup of coffee is a trigger; the lack of fiscal attentiveness is the cause and the basis for a fee—which is why the fee is assessed whether the coffee was paid for by check or debit card.

The bottom line is that customers are in the best position to know what their actual balance is – only they know what checks they have written, automatic payments they have authorized, and debit card transactions they have approved. It is important not to reinforce the

¹ See ABA Overdraft Fee Study, Ipsos U.S. Express Telephone Omnibus, (July 11-13, 2008).

² See attachment to ABA August 4' 2008 comment letter to proposed Regulation AA at <http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/54713/udapletter2008.pdf>

³ Eight of the nine participants indicated that they would keep the overdraft coverage, because they wanted to ensure that important transactions went through." (Page 8.) "Almost all indicated that they would want their cable bill covered, because having this bill paid would be worth paying an overdraft fee." (Page 9.) "Participants generally indicated that the overdraft coverage described in the disclosure was a positive feature for those who needed it, or for particularly important transactions." (Page 14.)

incorrect and harmful notion that customers may assume that banks are aware of all transactions that the customer has authorized and that it is not necessary for customers to keep track or use other available options to manage their accounts. For example, merchants will often forego transaction processing, especially for small dollar transactions which tend to draw the most attention. They verify that the card is valid, but choose not to get authorization. Thus, while the customer knows about the transaction, the bank has no knowledge of the transaction until it later arrives at the bank. Moreover, even if the merchant obtains authorization, transactions are not real-time, as some may assume. Typically, banks process in batch at the end of the day, first crediting the account with any deposits or credits and then deducting debits.

Simply put, customers are in control of their finances and can and do avoid overdraft fees. That the vast majority successfully avoid such fees has been confirmed by a recent FDIC survey that 75% of customers do not incur an overdraft fee in any given year.⁴

Overdraft accommodation programs have been very popular with bank customers specifically because they offer customers a convenient means of addressing occasional uncertainties in their account balances due either to customer oversight or to the timing of receipts into and payments from their accounts. Rather than being an obstacle to customer choice, overdraft programs are tools to accommodate customer choices in the management of their accounts and their preferences for conducting payment transactions.

I. Regulation E is the appropriate regulation to address overdraft accommodation practices regarding debit card transactions.

ABA in its July 30, 2008 comment letter on the Board's earlier proposal had argued that the Board's analysis of the proposed rule did not support any conclusion that paying overdrafts meets the three-prong test of an "unfair or deceptive act or practice." Instead, ABA recommended that any new regulatory mandates for consumer protection for debit card transactions be evaluated within the established regulatory framework for electronic transactions, funds availability, and account disclosures.

⁴ It is unlikely that the Board will receive letters from those who value and appreciate the service because it is a natural tendency of people not to take an initiative to write a letter when they are satisfied or unaffected by the subject, as indeed, the FDIC in its survey found. Rather, we expect that consumer comment letters are likely to come from consumers dissatisfied about an overdraft. In many of those cases, facts may be overlooked, forgotten, or not considered important that may be relevant and that could explain a bank response or put the situation in a different light.

The EFTA and its implementing Regulation E assign to the Board the responsibility “to provide a basic framework establishing the rights, liabilities and responsibilities of participants in electronic fund transfer systems.” According to the EFTA, “the primary objective of this [law] is the provision of individual consumer rights.”

Accordingly, Regulation E, coupled with Regulation DD, is the appropriate regulation to address concerns related to overdrafts, because much of the Board’s focus on overdrafts relates to debit card transactions, which are electronic fund transfers covered under Regulation E, rather than payment instruments such as checks, which are not covered under that regulation. Given that focus, it is important that the Board understand how customers may and do use debit cards, particularly in connection with debit card overdrafts they want paid, and how debit card transactions are processed and identified. This understanding is particularly essential in crafting a rule that permits bank customers to choose whether overdrafts may be paid and a rule that presumes one preference over another (i.e., opt in vs. opt out.)

II. The final rule should permit banks latitude when providing an election not to cover debit card transactions in an overdraft accommodation program.

The Board has offered two alternative proposals related to a bank’s ability to condition a customer’s choice to decline overdraft services for “ATM withdrawals and one-time debit card purchases” on the customer also declining such services for other types of transactions such as checks, ACH transactions, and recurring transactions. Under the “all-in” alternative, the bank may condition the customer’s choice to decline accommodation of debit card overdrafts on also declining accommodation of all overdrafts. Under the alternative “partial” opt-out or opt-in, the customer may decline overdraft accommodation for ATM withdrawals and one-time debit card purchases, but have other transactions, such as checks, ACH transactions, and recurring transactions, covered by the bank’s accommodation. We strongly encourage the Board **to permit** the “all-in” approach.

The “all-in” approach ensures that customers continue to have access to overdraft accommodation that consumer testing found that they value; recognizes the operational limitations of many bank and vendor payment systems; and avoids detailed disclosures and confusing explanations of what transactions are and are not covered.

- a) *Banks and customers should be allowed to harmonize the overdraft treatment of checks and check cards.*

Today, almost all debit cards that are suitable for purchases are identified with a major network brand. The cards themselves are often titled or marketed as “check cards.” In other words, they are promoted as doing the same things as checks do—only without the paper. Customers may make individual purchases, pay bills separately or even on a recurring basis. By the same token, unexecuted check card bill payments due to insufficient funds are as likely as bounced checks to incur merchant and payment recipient late fees. Distinguishing between overdraft accommodation for checks, but not for check cards, is the first step toward consumer confusion. For banks that want to keep a more simple identity, enabling them to use a single account-wide election for overdraft accommodation rationally places the emphasis on customer **account** management, not **payment method** management—especially when the different devices are used interchangeably to conduct the same types of transactions.

This emphasis on account level treatment puts overdraft accommodation on the same plane as other types of overdraft protection—e.g., linked deposit accounts, line of credit, or credit card back-up—all of which are applied across the account independent of the payment method used to conduct the transaction. In other words, an overdraft is an overdraft is an overdraft. Whether one overdraws into a line of credit by use of a debit card or by a check, the treatment (transaction payment and fee assessment) is the same. Banks do not, and need not, offer a partial credit line covering only checks or ACH and excluding debit card transactions. The credit line covers all account overdrafts by whatever means incurred. Overdraft accommodation programs should be allowed to be on a similar all-in or all-out footing.

As discussed in our July 2008 letter, the vast majority of banks lack the operational capability to allow or disallow debit card overdrafts on an individual account basis. In other words, if banks are to make debit card overdraft accommodation services available to any of their customers, they must make them available to all customers. This means that many banks would not be able to offer debit card overdraft services to any of their customers, including overdraft services for important debit card bill payments, which the Board’s consumer testing found consumers are likely to want paid.

Because the majority of banks would have to deny debit card overdraft accommodation services for **all** customers if the rule in effect permits customers the option to have only debit card overdrafts denied, and because consumer testing has indicated that consumers want important bills paid, including bills paid by debit card, we believe the final

rule should permit an “all-in” account wide option to reflect consumer preference.

b) Design of a partial election of overdraft accommodation for debit cards is constrained by the technical limits to differentiating different uses of a debit card and the difficulty in explaining those distinctions understandably.

In addition to allowing an account wide election of overdraft accommodation, banks should be permitted to design an understandable partial election of overdraft accommodation that enables the customer to decline coverage only for ATM and all other debit card transactions. To do so effectively warrants a closer look at how the system works and what its limits are when distinguishing among different debit card transactions.

If a partial option to decline coverage is permitted, the option would have to be for all debit card transactions, not just purchases. The proposal requires banks to allow customers the choice not to have overdraft fees applied to “ATM withdrawals and one-time debit card **transactions.**” [Emphasis added.] In contrast, the model disclosure instructs customers that they may choose to avoid having overdrafts paid on ATM withdrawals and “debit card **purchases** you make at a store, online, or by telephone.” [Emphasis added.] However, “one-time debit card transactions” and “debit card purchases” are not the same. One-time debit card transactions, for example, include not only purchases but also bill payments that the customer may individually schedule in advance or arrange at the last minute in order to avoid the consequences of paying late. Many bill payments are increasingly made by debit card, not only as a recurring payment, as the proposal seems to assume, but also as a one-time transaction. For example, customers may and do use a debit card number to pay a credit card or other bill. If they are paying close to the due date, for example, they may use a debit card number rather than a checking account number (if that option is available) because the checking account number or checkbook is often not readily available, whereas the debit card number is available because the card is typically carried in a wallet.⁵

However, from a processing stand-point, one-time bill payments are indistinguishable from any other one-time debit card transaction. For example, a customer’s online debit card authorization to pay a store credit card bill is indistinguishable from the customer’s debit card transaction to make an online purchase with that store. Accordingly, from an operational standpoint, it would not be possible to allow customers to choose to have one-time *purchases* declined, but have one-time *bills* paid: the bank

⁵ For these one-time transactions, the consumer does not necessarily know immediately if the transaction is rejected.

cannot distinguish between them. This means that the choice for customers is to have *all* one-time debit card transactions paid or declined -- whether the transaction is for purchase or bill pay purposes.

In addition, providing the choice to have recurring payments covered by overdraft services but one-time transactions declined is also not feasible. The Board notes in the Supplementary Information that industry commenters asserted that most systems today are unable to differentiate between point of sale ("POS") debit card transactions and other types of debit card transactions such as preauthorized transfers. However, the issue goes beyond "associated reprogramming costs."

Differentiating among debit card transactions simply cannot be done reliably. A merchant, such as a health club or utility, may obtain a customer's authorization to submit a debit card transaction each month for bill payment, but the merchant may submit each debit card transaction as a single item -- not as a recurring transaction. They may or may not indicate that a transaction is recurring. It is completely beyond the control of the card-issuing bank to obtain such information or ensure that such information is accurate. Therefore, the bank would not be able to make a determination to pay or deny a debit card transaction based on whether it is a recurring or one-time transaction. Yet, the banks are potentially liable for Regulation E violations. It would simply be unfair to impose a requirement with which the bank cannot comply and then subject it to liability for not complying.

In addition, even if the information were reliably available, it is not clear that the information could be conveyed to the place where the decision is made, absent significant programming changes. Furthermore, it would be detrimental to customers to suggest that they can assume that recurring transactions will be treated differently from one-time transactions when in fact they may not be.

While any partial choice would have to apply to all debit card transactions, including bill payments, the Board's consumer testing found that people do want and appreciate important transactions such as cable and utility bills paid, even if there are insufficient funds and they may have to pay a fee.⁶ They understand and want to avoid the consequences if the transaction is returned unpaid: fees and penalties imposed by the payment recipient; inconvenience of arranging payment; embarrassment; subsequent requirements that payments be made by money order; and potential negative reports to credit bureaus. While the testing questions sometimes referred to "recurring" payments, we do not believe that the preference to have important bills paid depends on whether the bill is

⁶ See footnote 3.

“recurring” or arranged on a per transaction basis. Customers have indicated that they want important bills paid and are willing to pay something for it.

Whether the final rule does or does not permit banks to condition the choice to decline debit card overdraft services on also declining overdraft services for other payment channels, it must make clear that declining overdraft debit card services applies to **all** debit card transactions, not just purchases, and that customers understand that it applies to purchases, bill-pay, and other transactions. Beyond the processing reasons that make parsing different types of debit card transactions not feasible, the most important reason is customer confusion. As illustrated, there are so many variations in how and where debit cards may be used and how they are processed, that it would be difficult if not impossible to explain the nuances and variations in a manner customers will understand. Such a lengthy and confusing explanation will discourage customer review, with the result that they will not understand the consequences of the choice they make. However, we think that they will easily understand “debit card transactions” with an explanation that it includes both purchases and bills paid using the debit card or debit card number.

In addition, if the Board permits or requires banks to offer a partial opt-out for debit card transactions only, the final regulation should also specifically permit banks to adjust parameters for ACH and check overdraft decisions based on any data that demonstrate either those who decline or those who accept the overdraft services are more or less likely to overdraw by ACH or check.

III. The final rule should enable customers to “opt out” of overdraft accommodation.

The Board has proposed two alternative proposed regulations: one, which would allow customers to “opt out” of overdraft services and a second, which would allow customers to “opt in.” We strongly recommend that the Board adopt the opt-out approach as it more closely aligns with consumer preferences as reflected in the Board’s consumer testing that showed that customers expect overdraft services and want important payments paid.

We know from the Board’s consumer testing that people expect and want important payments, including checks and ACH transaction (and presumably bill-pay debit card transactions) to go through, so opt-out is more consumer-friendly for these transactions. Indeed, the opt-out approach will also be more consumer-friendly for POS debit card transactions because there is less potential cost to bank customers in the event there are insufficient funds when they authorize a transaction. If

customers must opt-in to have transactions covered, they will have to imagine at the time of account opening being in a situation of having insufficient funds to cover transactions that they have authorized, how they will feel, and what their options may be. Many people, especially at account opening, do not anticipate having insufficient funds (hyperbolic discounting) and indeed, according to the FDIC's November 2008 "FDIC Study of Bank Overdraft Programs," only a small percentage (25%) overdraw in any given year. Later, perhaps years after opening an account, they may be turned down at a restaurant, having consumed a meal, or at the grocery store, having selected and rung up a cart full of groceries. However, at account opening or in a focus group, they might not think about the red face and embarrassment they may feel after having a transaction denied in front of a parade of strangers in the line behind them. Moreover, debit card transactions include bill payments and consumer testing found that people want important transactions paid, which would include debit card bill payments.

In many cases, customers will have limited choices if the debit card transaction fails. For example, a credit card may not be an option at POS in a store. Only 73% of families have credit cards according to the Board's recent *Survey of Consumer Finances*.⁷ Others with cards may not wish to use them for a number of reasons, and the merchant will be reluctant to accept a check (assuming the consumer is carrying one, which is less and less likely) given that the debit card transaction has just been declined for insufficient funds.

If the transaction is denied, whether for purchase or bill payment, bank customers' tendency is to be irritated with the bank. They may later contact the bank and opt in, but the damage in the customer relationship is already done. In contrast, if the customer does not opt out and the bank pays the overdraft, a customer unhappy with the fee may call the bank to complain. However, in order to keep the customer satisfied, the bank will often waive the fee for occasional or first-time overdrafts, a positive result for the customer. After the first overdraft, customers receive the notice of the right to opt out and can evaluate whether they want to forego overdraft accommodation or elect an alternative account solution, thereby avoiding any future overdraft fees.

It is also important to keep in mind that the goal and practice of any successful bank is to minimize negative customer experiences and negative conversations with customers. Opt-out minimizes the negative potentials when there are insufficient funds to cover a transaction initiated by a customer. Both opt-in and opt-out will potentially result in an irritated call to the bank, but with opt-out, the result is more likely to turn positive:

⁷ *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances*. February, 2009. Federal Reserve Board (Page A46).

the transaction the consumer initiates and authorizes is processed and a fee possibly waived in order to keep the customer happy. In contrast, with opt-in, the transaction is denied, causing embarrassment and inconvenience to the customer. It cannot be rectified after the fact. From the customer's standpoint, it is usually easier to have an overdraft fee waived than deal with the consequences of a declined transaction.

Additional evidence that customers understand and take advantage of overdraft accommodation services and the timing of transactions is illustrated by their behavior. For example, some customers are aware of and avail themselves of the fact that even with debit card transactions, there is often some window of opportunity to deposit funds *after* a transaction is made. In many cases, customers may make a debit card purchase in the morning – uncertain about their available funds at that time – and then later in the day transfer or deposit money into their account to cover the shortfall before the books are closed for that day.

Furthermore, it is clear from the Board's consumer testing that consumers understand the opt-out concept, whether for all payment types (Round One of testing) or for certain debit card transactions (Round Two of testing) and indeed, expect the service.⁸ Most of the participants in both the first and second rounds of testing opt-out notices were not surprised banks offered overdraft protection of this type, understood that they would be automatically enrolled, and understood the consequences of opting out. Further, "Participants generally indicated that the overdraft coverage described in the disclosures was a positive feature for those who need it, or for particularly important transactions." (Page 14, Second round.)

Moreover, the "default" choice should represent the preferences and behavior of most bank customers. Automated overdraft accommodation is an innovation that benefits the vast majority of customers who are covered by it and appreciate its presence when they inadvertently err in their otherwise responsible account behavior. Therefore it warrants being applied in opt-out form so that the minority who choose to decline its benefit may act on that preference without disadvantaging the majority of customers or the payment system itself.

⁸ Round one: "Almost all participants understood that they would automatically be enrolled in the overdraft coverage. . . ." (Page 7.) "Most participants were not surprised that a depository institution would offer overdraft protection of this type." (Page 8) "Most participants clearly understood the potential consequences of opting out of the overdraft coverage (for example, that they could be charged returned payment fees and could have transactions declined) and did not find them surprising." (Page 8.) "For the most part, participants understood how a partial opt-out of overdraft coverage would work." (Page 10.) Second Round (offered only partial opt out.): "All participants understood that they would be automatically signed up for this overdraft coverage if they took no action." (Page 14.) "Most participants were not surprised by the fact that a depository institution would offer this type of overdraft coverage, and had some previous exposure to similar types of coverage." (Page 14.)

Not only is opt-out the preferred default for its own policy reasons as we have outlined above, a partial opt-in alternative is more likely to mislead customers and promote adverse selection. For instance, by isolating individual attention on affirmatively requesting overdraft accommodation of debit card transactions, customers are more likely to believe they have bargained for guaranteed coverage. In reality, they have only asked for the bank to exercise its discretion in accordance with its overdraft accommodation policies and procedures. In other words, with opt in, an affirmative election, the suggestion is stronger that there is no discretion and that the transactions **will** rather than **may** be paid.

In addition, as the Board's proposal notes, an opt-in alternative encourages banks to "persuade consumers of the benefits of the overdraft service." This encouragement to pitch the value of overdraft accommodation—as if it were a negotiated service, risks attracting customers based on the prominence of the opt-in disclosures and may have the unintended effect of causing those with the more lax account management skills electing to rely on the bank's discretionary accommodation in lieu of being more conscientious about how they handle their account transactions or in lieu of more suitable options such as an overdraft line of credit. An opt-out regime avoids this dynamic because it reduces the need to promote the benefit and instead allows it to operate in the background as the back-stop to inadvertence that accommodation was developed to be.

However, should the Board adopt the opt-in approach, the opt-in should be limited to accounts opened after the compliance deadline. Customers who already have accounts should have the option to opt out, rather than be required to opt-in for accommodations they already expect and enjoy.

Under proposed Alternative 2 (opt-in), for accounts opened before the effective date, the opt-in notice must be provided on or with the first periodic statement after the effective date or following the first assessment on or after the effective date of any fee for paying an overdraft. For existing customers who have not opted in within 60 days of receiving the opt-in notice, the bank must cease assessing any overdraft fees, in effect, automatically dropping them from overdraft services. However, this does not necessarily represent customers' preferences. As the Board's consumer testing found, consumers value and expect overdraft services.⁹ Customers who rely and expect overdraft services, whether for ACHs, checks, or debit card transactions, but overlook or do not respond in time to an opt-in notice, may be surprised and extremely irritated when their payment is first returned unpaid and they then face the inconvenient and potentially expensive consequences. Automatically dropping all customers

⁹ See footnotes 3 and 8.

from coverage unless they opt in will cause great customer irritation and inconvenience, provoking a huge volume of complaints. For these reasons, customers of accounts already in existence at the time of the effective date should have the choice to opt-out.

IV. The final rule should allow reasonable variations in terms and conditions, but the Board should replace the proposed standard with a “reasonable or customary” standard, along with specific examples, that will provide regulatory clarity and not serve as a trap for expensive and unnecessary litigation.

The Board has offered two alternative proposals related to the ability of banks to apply different account terms or conditions based on whether the customer has accepted or declined overdrafts services. Under Alternative A to both Alternative 1 (Opt out) and Alternative 2 (Opt in), the bank must implement the consumer’s election regarding overdraft service by “providing to the consumer an account that has the same terms, conditions, and features... as provided to consumers who do choose overdraft services.” Alternative B to Alternative 1 permits banks to vary terms and conditions for the account that does not permit payment of overdrafts “provided that the differences in the terms, conditions, or features are not so substantial that they would discourage a reasonable consumer from exercising his or her right to opt out of the payment of such overdrafts.” Alternative B to Alternative 2 provides that the bank may vary the terms and conditions “provided that the differences in the terms, conditions, or features are not so substantial that they would compel a reasonable consumer to affirmatively consent to the payment of such overdrafts.”

We appreciate the Board’s recognition that there are legitimate reasons for account terms or conditions to vary depending on whether the customer has or has not declined overdraft services. We also understand and agree that any flexibility to vary terms or conditions not permit banks to circumvent the right to decline overdraft services by providing an illusory choice that would be overwhelmingly unattractive to most customers.

As the Board has suggested, there are legitimate reasons for terms and conditions to vary depending on whether the account provides overdraft services. Bank accounts are designed and priced based on numerous factors that include expenses and income, but also risk, that vary by account product, and account models balance these factors so that they align to make a profitable and attractive product. However, the key is that these factors must align. It is not possible to alter one side of the equation without altering the other and maintain that balance. Accordingly, banks should have flexibility to make reasonable alterations.

A comparison between free accounts with overdraft protection and accounts with fees for not maintaining a minimum balance illustrates this balance and alignment. The minimum balance requirement provides an incentive for customers to keep a balance that also serves as a cushion to ensure that payments are made even though customers might have misjudged how much they had in the account. For free accounts, overdraft protection serves as that cushion for those accounts. In other words, both a minimum balance requirement and overdraft protection serve to help ensure that customers' transactions are paid, (which is to their benefit) but in different ways and with different price and risk models.

However, if, as under the proposal, a bank cannot discourage account mismanagement by charging for overdrafts it cannot stop, that account presents a greater risk for which the bank is not compensated. Accordingly, it would be reasonable to reduce this risk by giving the customer an incentive to keep a cushion – by imposing a fee for falling below a minimum amount. A requirement that they be “customary” or “reasonable” would discourage terms that would render the right to decline overdraft services meaningless or illusory.

Other terms or conditions that will address the additional risk for an account that cannot be charged for overdrafts the bank cannot stop might include offering customers an account with another type of back-up, a line of credit or overdraft insurance, for which they qualify. In addition, a bank should be allowed to issue a debit card that requires that all transactions be authorized,¹⁰ helping to reduce the risk of unavoidable overdrafts. Another means of demonstrating “reasonableness” would be net revenue neutrality. For example, the variations in accounts would be permitted if the accounts with overdraft accommodation produce similar net revenues as those that do not. Being net revenue neutral would inhibit banks from discouraging customers from declining overdraft accommodation as there would be no monetary advantage.

While proposed Alternative B permits variations in terms and conditions, it is based on a “reasonable consumer’s” perspective. For the opt-out alternative, the test is whether the variation would discourage a reasonable consumer from opting out or, for the opt-in alternative, whether they are “not so substantial that they would compel a reasonable consumer” to opt in. Both of the proposed standards are so subjective as to be virtually unusable, especially in light of the potential liability. Who is a “reasonable consumer”? Is it one of the vast majority of those who do not overdraw their accounts? Or is it someone who puts his account on autopilot expecting the bank to assume the role of private accountant? Such a subjective standard will be vulnerable to regulatory challenge and

¹⁰ Some debit card transactions are not authorized prior to settlement. For example, some merchants choose not to obtain authorization in order to reduce processing time. The bank may have the option to return the item, but it is costly and time-consuming.

expensive liability under Regulation E. As a practical matter, banks acting in good faith could not rely on such a standard.

Nevertheless, we appreciate that for the right to decline overdraft services to be meaningful, there must be some constraint on permissible variations. We suggest that they must be “reasonable” or “customary.” Other laws, including the Uniform Commercial Code, for example, rely on such a standard. While this standard obviously also is subjective, the Board could add clarity with examples. Such examples could include those listed above, that is, fees when minimum balance is not maintained, a debit special card, alternative services such as an overdraft line of credit, net revenue neutrality. The commentary would also, as proposed, explain that automatic deprivation of a debit card because the customer opted-out of overdraft accommodation is not acceptable. However, the commentary should also clarify that banks may revoke debit cards for other valid reasons such as those applicable to debit card holders who have not opted- out; or if they abuse their account, for example, by incurring repeated debit card overdrafts. Without this option, the bank may be compelled to close such a risky account.

Allowing a test that permits a “customary” or “reasonable” option will allow flexibility and ensure constraint. “Customary” would provide a comparison that would constrain unacceptable terms and conditions but reduce litigation risks and documentation demands. “Reasonable” would allow banks to continue to innovate and not be limited to only terms and conditions already in the marketplace.

V. *The final rule should include an exception to the prohibition against imposing overdraft fees when a customer has declined overdraft services in cases where the customer requested the transaction, but the bank did not authorize the transaction.*

The proposal includes very limited exceptions to the prohibition against imposing a fee on overdrafts if the customer has declined the service. Specifically, the bank may impose a fee if:

- The bank has a reasonable belief that there are sufficient funds available in the customer’s account at the time the institution authorizes the transaction or
- In the case of a debit card transaction, the transaction is presented for payment by the merchant through paper-based means, rather than electronically through a card terminal, and the institution has not previously authorized the transaction.

The proposed Commentary offers examples of permissible exceptions:

- Balances not updated in real-time;
- Returned deposits;
- Settlement exceeds authorization amount; and
- Intervening transactions between authorization and settlement of a force pay debit card transaction.

In addition, the proposed Commentary provides that a fee may *not* be imposed if:

- A merchant does not submit a transaction for authorization before proceeding with the transaction; or
- A network is unavailable and the bank uses a “stand-in” processor to authorize the requested transaction.

ABA appreciates that the Board has recognized exceptions to the prohibition against imposing fees on customers who have declined overdraft services, but strongly recommends that the Board expand the exceptions to other situations that the bank cannot avoid. Otherwise, banks will have to 1) pay overdrafts 2) that they are unable to stop, 3) without compensation for the risk, and 4) which will harm customers by discouraging them from managing their accounts and monitoring transactions. Accordingly, we recommend that the Board except from the prohibition against imposing fees on customers who have declined debit card overdraft services, those transactions the bank has not authorized. The Board could provide a more effective notice than the one tested to ensure that customers understand that there are exceptions.

The Supplementary Information indicates that the Board recognizes that the bank would be unable to decline the transaction in certain circumstances if there were insufficient funds, but declined to except them from the rule because customers who have declined overdraft services have reason to expect the transaction to be declined if there are insufficient funds. This perception, in part, may relate to the Board’s consumer testing that showed that consumers did not understand the exceptions as the testers explained them.

In the first round of testing, the disclosure form explained that consumers might still overdraw their account “under limited circumstances outside of our control.” Participants did not notice this phrase and when it was pointed out, “did not understand what it meant,” though there is little further elaboration in the report summary of the testing on what they did not understand other than they were unable to identify what those specific situations might be or whether it was in the bank’s control or the consumer’s control. In the second round of testing, the phrase was only slightly changed: “There may be situations when, for reasons outside of

our control, you can still overdraw your account through an ATM or debit card purchase.” The summary of the testing does not indicated whether the phrase was relocated. The sentence was removed from the form after the first day of testing in the second round.

Nevertheless, the Board has permitted other exceptions that are beyond the control of the bank, for example, overdrafts caused by a returned deposit and intervening transactions between authorization and a force-pay debit card transaction. We agree that the regulation should retain these exceptions.

If there are to be exceptions, which there must be, as the Board has recognized, customers should understand generally that there may be occasions when there may be an overdraft and a fee imposed. Clearly, not informing them that there may be exceptions will promote the inaccurate perception that transactions are real-time and that they do not have to take steps to manage and monitor their account, but can instead rely on the bank to do so. The lack of important information will mislead them to their detriment. A notice is necessary to ensure customers understand the limits of declining the service, and a general notice, rather than one that attempts to provide all the specifics, is more informative and useful.

If there are to be exceptions and a notice anyhow, there is no need to exclude other legitimate exceptions if a better disclosure could be devised. The testers only slightly altered the statement from the first round before testing in the second round and then deleted any reference on the second day of that round. In addition, they did not appear to relocate or highlight the notice after the first round, as they did for other information that participants had overlooked or not understood. The testers also seemed focused on participants understanding the precise meaning of “circumstances beyond our control” rather than on the more general message most useful to consumers – that even though they have declined the service, there may be times when the bank cannot stop a payment (including debit card transactions the customer authorizes) and they may still overdraw their account and have to pay a fee. The disclosure could also offer brief examples to illustrate.

In effect, the proposed right to decline overdraft services advances the inaccurate notion that transactions are real-time, a perception that harms consumers. It would be better for bank customers to move toward taking responsibility for keeping track of and monitoring transactions and balances, as this will serve them better in the long run – not just for avoiding overdrafts, but for other reasons, including detection of unauthorized transactions and monitoring of spending.

In addition, in instances where the merchant does not obtain a required approval, the card issuing bank is permitted to return the transaction, though there may be a significant fee to the bank for doing so. For example, merchants submitting small dollar transactions or paper transactions¹¹ sometimes do not obtain prior approval. While we would not expect banks to use this option absent abuses, the return item fee, like a return check or ACH fee, could be imposed on the customer.

VI. The Board should adopt the proposed prohibition related to debit card holds and overdraft fees. However, “reasonable time” should be considered the end of the processing day. In addition, the regulation should require merchants to submit transactions by the end of the processing day of the authorization.

Under the proposal, banks may not assess an overdraft fee if the overdraft would not have occurred but for a hold related to a debit card transaction if the actual amount of the debit card transaction can be determined by the merchant within a short period of time after authorization. A bank may assess a fee, however, if the bank has procedures and practices in place designed to release a debit hold within a reasonable period of time. Under the proposal, two hours after authorization is considered reasonable. The rule generally will apply to gas pump and restaurant transactions, but not to hotel and car rental transactions.

Generally, we agree with the principle that customers should not incur overdraft fees if the overdraft fee is caused solely by the existence of the hold. However, as the Board recognizes, there are significant operational issues in many circumstances where it is not feasible to ensure that there will be funds to cover the transaction without causing an overdraft. In these situations, banks often waive the fee when the customer notifies the bank.

We agree that the rule should not apply to instances when the amount of the final transaction cannot be determined within a short period of time, as is the case with car rentals and hotels. As the Board points out, overdraft fees are less likely to occur in these instances because customers currently tend to use credit cards for these transactions. The Board also notes that it has received few complaints about overdraft fees incurred as a result of debit holds placed in connection with hotel and car rental transactions.

¹¹ The acquiring bank converts the paper transaction to electronic format so that the card issuing bank is unaware of its paper origins, so cannot elect to pay as an overdraft and impose a fee, as the proposal permits under the exceptions.

However, we recommend that “reasonable time” be considered the end of the processing day and that the regulation require merchants to submit transactions by the end of the processing day of the authorization. The only way to begin to resolve the issue is to engage all relevant parties, which include the merchant, card associations, and the card acquiring and issuing bank. While not a perfect fix, it will move the industry closer to a system that minimizes and perhaps ultimately eliminates the problem.

The two hours timeframe will work for most gas stations, because many now will present the actual transaction within two hours. However, restaurants and some gas stations may not be able to submit transactions within that time frame. Some gas stations, particularly small size gas stations, and many restaurants use “batch processing,” which means that the actual amount of the transaction will be submitted later than two hours after authorization, up to three days after the transaction. If the bank must release the hold on the full amount it is obligated to pay the merchant before it knows the final amount, it risks a loss, which raises safety and soundness concerns. While some banks may choose to release the hold because at a given time and situation the risk is manageable, they should have the ability to respond when greater risks are present or change.

We believe that while many of the merchants that lack the capacity to submit the actual transaction amount within two hours, they will be able to do so by the end of the of the processing day.

VII. The final regulation should provide model language for banks offering customers the option to decline overdraft services for all transactions.

The proposed model forms only apply to situations where the customer has the option to decline overdraft services for “ATM withdrawals and debit card purchases” only. Indeed, the proposed models suggest that other transactions, however, may be paid. “Your decision to opt out will not affect whether we pay overdrafts for other types of transactions including checks.” This suggests that customers do not have the option with regard to checks and ACH overdrafts, though we expect that some banks will also give customers the option to have these overdrafts declined. It would be helpful to have model disclosures for these situations to ensure that customers are not misled and understand their options, as well as to facilitate compliance.

VIII. The notice should include disclosures of fees for denial of debit card transactions, if applicable.

The final regulation should require that if applicable, the notice should disclose any fee for debit card transaction denials or charge-backs.

Some institutions may impose a fee for debit card transaction denials, as banks incur costs for denials (network fees, operation expenses etc.). Moreover, some customers will “keep track” of or routinely balance their accounts by attempting transactions rather than using less costly and readily available options. Some banks may choose to impose fees to recoup costs and discourage inappropriate overuse rather than have other, more responsible customers absorb the costs.

IX. The period to opt out should be shorter, and banks should have options on how customers may opt out.

Under proposed Alternative 1, banks must provide an opt-out notice and provide customers a “reasonable opportunity” to opt out. Under the proposed Commentary, a “reasonable opportunity” to opt out is considered 30 days from the date the customer is provided the opt-out notice. We believe that ten days is sufficient. Banks report that most people who opt out after receiving a privacy notice opt out within five days at the most. It is natural for people to act immediately or very soon after receiving a notice. It is unlikely that they will wait 30 days.

In addition, the proposed commentary offers examples of reasonable opportunities to opt out, including by mail, telephone, electronically, or at time of account-opening. The Commentary should be clear that banks are not required to provide all these options and should be able to request verification of the choice in writing. It may not be feasible or efficient for banks or necessary to consumers to offer all the options listed.

X. Transactions made through decoupled debit cards should not be considered debit card transactions for purposes of the overdraft accommodation rule, and the decoupled debit card issuer should inform the customer.

Decoupled cards are debit cards offered by institutions other than the account holding institution that consumers use as they would any other debit card. The difference is the method of processing. The decoupled debit card transactions are processed as ACH transactions. This means that the account-holding institution cannot know that the transaction is a debit card transaction that should be returned if there are insufficient funds and the customer has declined overdraft services for debit cards.

Accordingly, any rule that allows customers to choose not to have debit card overdrafts paid but have other overdrafts paid must except decoupled debit card transactions from inclusion in the category of debit card transactions. In addition, the exception for decoupled cards could not be easily or properly explained in the deposit account-opening

disclosures. Moreover, it is unlikely to be relevant to customers as they are not making a choice about a decoupled card when opening a deposit account. Accordingly, it would have to be added to the disclosures provided by the decoupled card issuer.

XI. The Board should use the term “overdraft accommodation” to avoid consumer confusion and should clarify in the definition that the payment of overdraft for these programs is discretionary.

Under the proposal, the Board uses the term “overdraft services” and defines it as:

A service under which a financial institution assesses a fee or charge on a consumer’s account held by the institution for paying a transaction (including a check or other item) when the consumer has insufficient or available funds in the account. The term “overdraft services” does not include any payment of overdrafts pursuant to –

- (1) A line of credit subject to the Federal Reserve Board’s Regulation Z (12 DCFA part 226, including transfers from a credit card account, home equity line of credit, or overdraft line of credit; or
- (2) A service that transfers funds from another account held individually or jointly by a consumer.

We suggest that the Board use the term “overdraft accommodation” rather than “overdraft service” to capture better the discretionary nature of the practice and to ensure customers are able to distinguish among other types of overdraft “services” such as the ones the proposed rule describes among the exclusions.

As illustrated in the proposed regulation, “overdraft service” embraces not only discretionary programs but also overdraft lines of credit and services that pay overdrafts from another account. Indeed, the proposal itself uses the term “service” to describe **a different** overdraft program that links the checking account to another account. We can expect customers also to assume that “service” might include something other than the overdraft accommodation program and cause confusion. Using a different term than “service,” which may apply to several programs, will help ensure customers understand. Moreover, “accommodation” reinforces that the bank is not obligated to pay, an important fact for customers to understand. In many ways and for many banks within the wide cast of this proposal, overdraft accommodation is

much more of an exception policy than it is a service or even an account feature.

Accordingly, to facilitate customer understanding and add regulatory clarity, we suggest that the term and definition be modified to read as follows:

- (a) *Definition.* For purposes of this section, the term “overdraft accommodation” means a practice or program under which a financial institution assesses a fee or charge on a consumer’s account held by the institution for paying a transaction (including a check or other item) at its discretion when the consumer has insufficient or unavailable funds in the account. The term “overdraft accommodation” does not include any payment of overdrafts pursuant to—

XII. The Board should allow at least 18 months for banks to implement the final regulation.

The Board should allow at least 18 months for banks to implement the final regulation. Any final regulation will require more than minor adjustments. Rather, after reviewing and analyzing the final regulation and determining how to implement it, banks will have to work with core processors and third party vendors that handle their processing, modify existing software and other systems or install new ones, and test these systems. In addition, banks will have to train employees and educate their customers. Sufficient time is particularly critical for our small bank members who rely on third party vendors. Moreover, the regulation may require card network rule changes which cannot occur until after adoption of final regulation.

XIII. Conclusion

Because overdraft accommodation programs recognize that customers benefit from having back-up protection against their occasional error, enable customers to reasonably avoid overdraft fees by responsibly managing their accounts and provide for a more effective payment system by minimizing unnecessary returned items, the use of these policies or programs are not unfair practices, but rather are beneficial practices on an individual and a system-wide basis. Therefore, we strongly support the Board’s decision to shift the rule into Regulation E under the Electronic Funds Transfer Act’s mandate “to provide a basic framework establishing the rights, liabilities and responsibilities of participants in electronic fund transfer systems.”

To ensure that consumers continue to have choices and access to a program the Board’s testing showed consumers expect and value, ABA

recommends that the final rule permit banks latitude when providing an election not to cover debit card transactions in their overdraft accommodation programs—permitting either an “all-in” account level choice or a partial election limited to debit card transactions that properly recognizes how they are used and processed given operational limitations. In addition ABA urges the Board to adopt a rule based on a customer’s right to opt out of overdraft accommodation programs and for banks to satisfy that option by offering alternative accounts that are reasonable or customary.

Finally, we encourage the Board to recognize the evolving nature of electronic payments and the need to continue to place the responsibility for account management on the accountholder. Whether transactions settle in near real-time or by daily batch processing, the customer is still the only one who knows what is in the transaction pipeline before it gets to the bank. Technology is a great enabler for enhancing consumer choice in the financial market-place; but its use still depends on individual responsibility for using it wisely. Automated overdraft accommodation is an innovation that benefits the vast majority of customers who are covered by it and appreciate its presence when they inadvertently err in their otherwise responsible account behavior. Therefore it warrants being applied in opt-out form so that the minority who choose to decline its benefit may act on that preference without disadvantaging the majority of customers or the payment system itself.

We are happy to discuss our comments and provide any additional information.

Sincerely,



Nessa Eileen Feddis