



Capital One Financial Corporation
1680 Capital One Drive
McLean, VA 22102

March 30, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Proposed Regulation E Overdraft Rules (Docket No. R-1343)

Dear Ms. Johnson:

Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A. and Capital One Bank (USA), N. A., collectively had \$109 billion in deposits and \$210 billion in total managed assets as of December 31, 2008. In addition, Capital One's newly acquired subsidiary, Chevy Chase Bank, F.S.B., had more than \$16 billion in assets and \$13 billion in deposits as of December 31, 2008. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients. Capital One, N.A. and Chevy Chase Bank, F.S.B. have approximately 1,000 branch locations primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia, and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Capital One is pleased to submit comments on amendments to Regulation E proposed by the Federal Reserve Board ("Board").¹ This proposal was issued in conjunction with final Regulation DD rules requiring overdraft fee disclosures on periodic statements and balance disclosures provided through automated systems.²

¹ Proposed Regulation E, 74 Fed. Reg. 5212 (January 29, 2009).

² Final Regulation DD, 74 Fed. Reg. 5584 (January 29, 2009).

The Board first issued guidance and Regulation DD rules regulating advertised and promoted overdraft coverage in 2005.³ Last year, the Board proposed Regulation DD and Regulation AA rules that would apply to banks even if they do not market or promote their overdraft coverage.⁴ These proposed rules required banks to give deposit account customers disclosure of their right to opt out of having overdrafts covered. The right to opt out could cover any type of transaction that may overdraw the deposit account or could be limited to debit card transactions at the automated teller machine (ATM) and point of sale terminal (POS). The proposed Regulation AA rules and opt out portion of the Regulation DD rules were withdrawn and the current Regulation E proposal was issued.

The Regulation E proposal would limit the ability of a bank to assess an overdraft fee for paying ATM withdrawals and one-time debit card transactions that overdraw a consumer's account, unless the consumer is given notice of the right to opt out of the payment of such overdrafts, and the consumer does not opt out. As an alternative approach, the proposal would limit the ability of a bank to assess an overdraft fee for paying ATM withdrawals and one-time debit card transactions that overdraw a consumer's account unless the consumer affirmatively consents, or opts in, to the institution's payment of overdrafts for these transactions.

Capital One believes in empowering its customers with notice and choice. We have advanced this position in our public statements as well as in our business practices.⁵ Capital One currently provides opt-outs to our customers if they do not want us to cover overdrafts on their deposit accounts. In addition, to help our customers avoid overdrafts, we provide many means for them to view their account balance, including through online banking, mobile banking, phone banking, ATMs and bank branches. We also offer an account alert system that notifies a customer by phone, email, or wireless device when their balance is below a certain threshold. Additionally, we allow for instant transfers to/from our checking and savings/money market accounts. We even allow transfers to or from any bank or brokerage. All these services are offered to our customers free of charge. In keeping with our position and practices, Capital One supports the Board's

³ Interagency Guidance on Overdraft Protection Programs (Overdraft Guidance), 70 Fed. Reg. 9127 (Feb. 24, 2005). Final Regulation DD, 70 Fed. Reg. 29582 (May 24, 2005).

⁴ Proposed Regulation DD, 73 Fed. Reg. 28739 (May 19, 2008). Proposed Regulation AA, 73 Fed. Reg. 28904 (May 19, 2008).

As discussed in our 2008 Overdraft Letter, we believe that the Board should continue to recognize the distinction between overdrafts programs that are marketed and promoted and those that are not. Capital One does not promote or advertise its courtesy coverage. In adopting this policy, Capital One seeks to avoid encouraging customers to rely excessively on such coverage. Such excessive reliance is not only costly for customers but also may potentially increase risk for the institution.

⁵ Capital One Letter on Proposed Regulation DD and Proposed Regulation AA of July 18, 2008 (2008 Overdraft Letter); Letter on Proposed Regulation AA Credit Card Rules of August 4, 2008; and Letter on Proposed Regulation Z of June 14, 2007.

Regulation E proposal as it is an advance in empowering consumers with notice and choice. While we support the principles articulated in the proposal, we believe that certain modifications are necessary to avoid unintended consequences and enhance the objectives of the rules.

The opt out alternative, coupled with recent amendments to Regulation DD, permits institutions to offer a valuable service and adequately protects consumers.

As discussed above, the Board proposes that consumers be given the right to opt out of having overdrafts covered when caused by ATM or one-time debit card transactions.⁶ As an alternative, the Board proposes that customers be given the right to consent or opt in to having such overdrafts covered.⁷ We believe that the opt out alternative provides a reasonable solution that will permit banks to provide the overdraft service to those consumers who find it valuable, yet protect those consumers for whom the service is not worthwhile.

Capital One's own experience is consistent with data cited in the proposed rule that a substantial majority of consumers do not overdraw their account in a given year.⁸ We believe that particularly for these consumers who occasionally overdraw their account, the overdraft service that we and other institutions provide is often of great value in paying for a transaction that would otherwise be declined. Indeed, in these tough economic times, consumers, particularly more vulnerable consumers, may have fewer payment alternatives available to them than they have had in years past. A declined transaction may therefore have more detrimental effects. Indeed, as discretionary overdraft service is the status quo, consumers expect banks to provide this service. The opt out alternative would be consistent with consumers' expectations of what services are available to them.

A small minority of consumers are assessed multiple overdraft fees when there may be lower-cost alternatives available to them for such short-term credit.⁹ Like others, we have concerns about these consumers and, in refraining from marketing the discretionary overdraft service, we avoid encouraging such consumers to rely excessively on the service. As the Board noted in the proposed rule, consumers will often adhere to an established default rule,¹⁰ which raises the concern that in an opt out regime, those most vulnerable consumers will not exercise their right to an opt out but instead continue to be assessed multiple fees.

⁶ Proposed §205.17 Alternative 1.

⁷ Proposed §205.17 Alternative 2.

⁸ Proposed Regulation E, 74 Fed. Reg. at 5225.

⁹ Final Regulation DD, 74 Fed. Reg. at 5587 ("A small segment of consumers incur the majority of overdraft fees.")

¹⁰ Proposed Regulation E, 74 Fed. Reg. at 5225.

In the proposed opt out regime, however, we believe that all consumers will have multiple meaningful opportunities to learn about the costs of overdraft coverage and other options available to them and to demonstrate their choice as to overdraft coverage, so as to weaken significantly the potential effect of inertia. First, the proposal requires institutions implementing an opt out regime to provide notice of the opt out right not only at account opening, but each and every time an overdraft fee is assessed.¹¹ Second, institutions must also state whether they provide any alternatives for the payment of overdrafts and how to obtain more information about those alternatives.¹² Third, the opt out right notice would be in addition to a chart on each periodic statement summarizing the total amount of overdraft fees that have been assessed for each statement period and year-to-date, as applicable.¹³ We believe that the cost-benefit analysis of an approved ATM or one-time debit card transaction versus the overdraft fee, both one-time and on an ongoing basis, will be made very clear to consumers in an opt out regime. Accordingly, we believe that the opt out alternative minimizes the negative effects of the new rule, as it fairly places the burden on those who do not value overdrafts to opt themselves out of the service and permits other consumers who benefit from the occasional payment of overdrafts to take advantage of the overdraft service.

The opt in alternative is more likely to mislead consumers, cause over-reliance on overdraft services, and trigger credit disclosures.

The opt in alternative may mislead consumers

While Capital One supports the opt out alternative, we are concerned that the consent or opt in alternative leads consumers to believe that if they consent, the bank *will* cover overdrafts occurring by ATM or one-time debit card transactions. In fact, institutions may decide not to cover an overdraft since they have a legal right, as well as a safety and soundness obligation, to reject transactions when there are insufficient funds in customers' accounts.¹⁴ Nevertheless, consumers may believe that they are consenting to having all overdrafts by ATM and at POS covered. They may reasonably believe that since non-consent under the opt in alternative results in no ATM and debit card overdrafts being covered, consent must mean that all such overdrafts will be covered.¹⁵ This misunderstanding is far more likely to occur under the opt in alternative than the opt out alternative because the formal communication and conscious action required to

¹¹ Proposed §205.17(c)(2).

¹² Proposed §205.17(d)(1)(v).

¹³ Final Regulation DD §230.11(a).

¹⁴ 2008 Overdraft Letter at 6. The letter also noted that Uniform Commercial Code 4-402 makes clear that a bank has no duty to pay an overdraft. Payment of the overdraft is left to the bank's discretion and agreement with its depositor.

¹⁵ Of course, either alternative would be subject to certain exceptions where overdraft services may be provided and a fee assessed. Proposed §205.17(b)(5).

consent, as compared to the simple act of refraining from opting out, will lead consumers to believe that they are entering into an agreement for a service or benefit, instead of agreeing to let their bank decide if it wants to cover an overdraft.

This fundamental problem with the opt in regime is reflected in the Board's model opt in disclosure, which implies that overdrafts will be covered. Entitled "Model Consent Form for Overdraft Services" it states in bold underlined words:

Your Right to Request Overdraft Coverage

How to Request Overdraft Coverage or Get More Information

In regular font, the model opt in disclosure goes on to state:

We will not pay your overdrafts for ATM withdrawals and debit card purchases you make at a store, online or by telephone, unless you tell us you want overdraft coverage for these transactions. [underline in the original].

See below for more information, including how to contact us if you want overdraft coverage to apply to your ATM withdrawals and debit card purchases.

To request overdraft coverage for your ATM withdrawals and debit card purchases...please contact us.

The model disclosure implies that by consenting, the consumer's overdrafts will be covered. Adding to this confusion, the first bold and underlined statement above could reasonably be interpreted to suggest that overdraft protection is a consumer "right," rather than a discretionary service offered by the bank. This is not due to any drafting flaw, but rather to the fact that the notion of an opt in is inconsistent with a service that is discretionary and not contractually or otherwise guaranteed. It is difficult to accurately explain the effect of an opt in on a service that lies solely in the institution's discretion, and thus the opt in alternative will likely mislead and confuse consumers.¹⁶

¹⁶ The model disclosure contains one statement in regular font that "having overdraft coverage does not guarantee that we will pay your overdrafts." However, as the Board itself noted in its guidance on unfair or deceptive acts or practices, disclaimers may be insufficient, especially when consumers' attention are drawn away from the disclaimer. The Board and FDIC jointly stated

Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosures is unnecessary. Likewise, oral disclosure or fine print may be insufficient to cure a misleading headline or prominent written representation.

The opt in alternative may encourage over-reliance

In addition to likely confusion associated with the opt in alternative, we have concerns that an opt in alternative would cause more institutions to promote or advertise the overdraft service. In the proposal, the Board notes that with the opt in alternative, institutions will have an incentive to “persuade consumers of the benefits of the overdraft service”.¹⁷ We agree that institutions will need to explain the overdraft service and the advantages and disadvantages so that consumers, especially those with only occasional overdraft experience, understand the merits of the service. We have concerns, however, that an unintended effect of the opt in would be that institutions that today do not market or promote the overdraft service would more aggressively market the service.¹⁸ This could have the unintended effect of more consumers over-relying on the overdraft service, which could be costly for consumers and increase risk for institutions.

The opt in alternative may trigger Regulation Z

The opt in alternative is further troubling because it may result in Regulation Z applying to the courtesy overdraft service. If Regulation Z applies, cost disclosures, including the disclosure of the annual percentage rate (APR), may be required. Regulation Z states that overdraft fees are not finance charges if the charges are “imposed by a bank for paying items that overdraw an account, *unless the payment of such items and the imposition of the charge were previously agreed upon in writing.*”¹⁹ Emphasis added. In other words, a written agreement to cover overdrafts will result in overdraft fees being deemed finance charges and may trigger Regulation Z cost disclosures. Since the opt in alternative by its nature requires a written disclosure to consumers, and as discussed above, consumers may believe that their consent is an agreement for their bank to cover overdrafts, some may interpret the opt in notice to be a written agreement to cover overdrafts. As such, any assessed overdraft fee may be deemed to be a finance charge and trigger Regulation Z’s APR disclosure. Under the opt in regime, Regulation Z disclosures may be required.

As the Board decided when it first issued overdraft rules in Regulation DD in 2005, Regulation DD and not Regulation Z is the appropriate regulation to offer

In this case, the lone statement that overdrafts may not be covered is insufficient to overcome the bolded underlined titles and the numerous descriptions implying if not stating that there is a right to have overdrafts covered.

¹⁷ Proposed Regulation E, 74 Fed. Reg. at 5225.

¹⁸ This concern is especially prominent now that under the final Regulation DD rules, all institutions, not just those promoting overdraft services, must disclose total overdraft and return item fees on periodic statements. Final Regulation DD §230.11.

¹⁹ Regulation Z §226.4(c)(3).

consumers notice and protection.²⁰ Regulation Z cost disclosures for a courtesy coverage of an overdraft are not helpful to consumers because, in order to calculate the APR, assumptions have to be made regarding the amount of an overdraft and the length of time before the consumer repays the overdraft. Such an APR calculation would not accurately describe and would not help consumers understand the cost of their overdrafts. Furthermore, as the Board found in its consumer testing of credit card periodic statements, consumers find cost disclosures explained in dollar amounts more meaningful than explained as APRs.²¹ As such, overdraft cost disclosures required under Regulation DD would be more meaningful to consumers than overdraft APR disclosures under Regulation Z. The fact that the opt in alternative may trigger Regulation Z disclosures will result in higher burden and cost for financial institutions without any benefit to consumers.

For the above reasons, the opt out alternative is less likely to confuse consumers about the scope of their right and less likely to trigger unhelpful Regulation Z cost disclosures. As such, we believe it is more appropriate to have an opt out regime with, if done carefully, the opt in permitted as an exception to the opt out default rule.

Institutions should be given the flexibility to determine overdraft coverage for check and ACH transactions.

The Board requests comment on whether Regulation E should prohibit a bank from requiring that a consumer's opt out of (or lack of an opt in for) overdraft coverage for ATM and one-time debit card transactions (partial opt-out) also results in an opt out of coverage with respect to checks, ACH transactions or other types of transactions (general opt-out).²² We strongly believe that a bank should be permitted to offer a general opt out instead of a partial opt-out. As the Board noted, there is a high cost and level of operational complexity to offering partial opt-outs. Institutions would not only have to stop overdraft coverage on an account-by-account basis based on a consumer's opt-out, but would be required to stop overdraft coverage for only certain types of transactions while maintaining coverage for other types of transactions. Furthermore, the partial opt out may present consumers with a misleading impression of their right to direct their bank to pay certain overdrafts. A general opt out would clarify for consumers that they may stop all overdraft coverage but that they do not have a right to pick and choose which overdrafts will be covered under this discretionary service. For these reasons, institutions should be able to over-comply with the rule by offering a general opt out instead of a partial opt-out.

²⁰ The Board in 2002 requested comment on discretionary overdraft services and whether they should be covered under Regulation Z. Proposed Regulation Z, 67 Fed. Reg. 72618 (December 6, 2002). Subsequently, the Board rejected coverage of the service under Regulation Z and instead issued proposed and final Regulation DD rules covering services that are advertised to consumers. Proposed Regulation DD, 69 Fed. Reg. 31760 (June 7, 2004); and Final Regulation DD, 70 Fed. Reg. 29582 (May 24, 2005).

²¹ Final Regulation Z, 74 Fed. Reg. 5244 (January 29, 2009) at 5316-19.

²² Proposed §205.17(b)(2)(i).

Similarly, the Board proposes prohibiting institutions from declining to pay checks, ACH transactions, or other types of transactions that overdraw a consumer's account because the consumer has opted out of (or not opted in to) overdraft services for ATM and one-time debit card transactions.²³ For safety and soundness reasons, a bank should be able to consider all relevant information available to it when deciding whether to cover transactions by check, ACH, or other means (*e.g.*, preauthorized electronic funds transfers). For example, if consumers' decision to opt in to overdraft coverage is an indicator of higher risk of not repaying overdrafts, institutions should be permitted to consider a consumer's opt in decision in deciding whether to cover checks and ACH transactions drawn against insufficient funds. For safety and soundness reasons, the final rule should permit institutions to take into account consumers' opt in or opt out decision when deciding whether to cover transactions by check, ACH or other means.

Institutions should be given the flexibility to design account terms and features based on consumer demand, the evolving competitive landscape, and safety and soundness concerns.

The Board presents two alternatives with regards to setting the terms, conditions, and features on accounts for consumers who opt out (or not opt in).²⁴ Under Alternative A, the rule would require institutions to provide to consumers who opt out, an account with the same terms, conditions and features, including interest rates paid and fees assessed, as those consumers who do not opt out. Under Alternative B, the rule would permit institutions to alter some account terms, conditions or features, provided that the differences are not so substantial that they would discourage a reasonable consumer from exercising his or her opt out or opt in right.

Because we believe that institutions must have the flexibility to design product and feature sets based on consumer demand, competitive factors, and safety and soundness concerns, we appreciate the Board's effort to provide institutions with flexibility in Alternative B and have concerns with the Board's Alternative A. As a baseline, it is important to reiterate that overdraft protection is a service, not a right. Like any service, its use or non-use, must be considered as part of the overall economics of a product, and therefore, the pricing and other terms associated with that product. Put more broadly, institutions must have the ability to design products based on the relevant information available to them. For example, if institutions determine that those consumers who do not opt out or who opt in are lower risks or are more likely to utilize the institution's ATM and debit card services, institutions should be able to offer different products to these groups of consumers.

In the competitive financial services industry, consumers are accustomed to choosing from different account features, services and associated fees when selecting a

²³ Proposed §205.17(b)(2)(ii).

²⁴ Proposed §205.17(b)(3).

new account. Consumers are provided clear and conspicuous disclosures regarding these features, as required by Regulations E and DD, so that they may comparison shop between multiple institutions. Institutions should be permitted to design product and service combinations in good faith, so that consumers are able to select from a slate of accounts the one that is most beneficial for them, based on their anticipated account and service usage. As such, we support the Board's Alternative B, with further guidance on what account differences are acceptable. One suggestion is a principle-based standard where reasonable product differences are permitted so long as they are not in place for the sole purpose of discouraging opt-outs or opt-ins.

Implementation time depends on scope of the rule.

The Board requests comment on the amount of time needed to implement the final rule. The effort, cost, and time needed to implement the rule depends on what is permitted and required by the final rule. If the Board chooses the opt out alternative and permits institutions to offer a general opt out (instead of mandating a partial opt-out) we would be able to implement the rule relatively quickly. An opt in or a mandated partial opt-out/opt in rule would require a much longer implementation time since substantial changes to systems, policies, and procedures must be made. If substantial changes are required, we note that these are challenging economic times nationally and that institutions are currently implementing substantial changes to their systems to implement other laws and regulations. Staggering the implementation of the final Regulation E rules after the required implementation of these other laws and regulations would be helpful.

Other issues

We have other suggestions about the proposed amendments:

- Opt Out Time Period. For the opt out alternative, we do not believe that a 30-day opt out time period after provision of the initial notice is necessary in order to give the consumer a reasonable opportunity to opt out. Based on our experience with implementing other opt outs, we find that consumers who choose to opt out generally do so soon after provision of the notice, with the opt-outs peaking approximately five days after delivery of an opt out notice. As such we believe that a 15-day opt out time period would be reasonable.
- Clarification of Exceptions. We appreciate the Board providing the exceptions to the proposal's fee prohibition in recognition of the complexity of the various payment systems.²⁵ However, consumers may not understand that such exceptions and operational complexities exist. They may be confused and upset if they opt out and yet are properly assessed an overdraft fee for an ATM or debit card transaction that overdrew the account. We believe that the model opt out

²⁵ Proposed §205.17(b)(5).

form should refer generally to these exceptions, so that consumer expectations will be set.

- Written Confirmation of Opt In. Although we do not believe that the opt in alternative is the preferred approach, if the opt in alternative is selected, we do not believe that institutions should be required to provide written confirmation of the consumer's consent.²⁶ The Board notes that the written confirmation will help ensure that the consumer intended to opt in to the service. However, given the protective mechanisms already in place within the opt in alternative – *e.g.*, the consumer must affirmatively opt in; the opt in notice must be segregated from everything else, including all other account disclosures; and the notice must contain only information specified within the overdraft services section of Regulation E – we believe that the cost to the bank would greatly outweigh any perceived benefit to the consumer.

* * *

Capital One appreciates the opportunity to comment on the Board's proposed Regulation E overdraft rules. If you have any questions about this matter or our comments, please call me, Ducie Le, at 703-720-2260, or Candace Davis, Assistant General Counsel, at 703-720-2253.

Sincerely,



Minh-Duc T. Le
Assistant General Counsel, Policy Analysis

²⁶ Proposed §205.17(b)(1)(iii).