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By Electronic Delivery

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

Subject: Federal Reserve Board Docket No. R-1343
Proposed Amendment to Regulation E Regarding Overdrafts

Dear Ms. Johnson:

This letter is submitted by Citigroup Inc. ("Citigroup") on behalf of itself and its subsidiaries, in response to the proposal (the "Proposal") of the Federal Reserve Board (the "Board") to modify Regulation E[1], which implements the Electronic Fund Transfer Act[2].

Background

In May, 2008, the Board, along with other bank regulatory agencies, proposed to exercise its authority under Section 5 of the Federal Trade Commission Act[3] ("Section 5") to enact a newly-adopted Regulation AA, that would, among other things, prohibit institutions from assessing any fees for payments of overdrafts on a consumer's account unless the consumer was provided with a notice and the right to opt out.

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[1] 12 C.F.R Part 205
[2] 15 U.S.C. § 1693 *et seq.*
[3] 15 U.S.C. § 45

The opt-out right would have applied to fees resulting from overdrafts relating to any method of payment (e.g., check, ACH), although consumers could select a more limited opt-out that would apply only to the payment of overdrafts for ATM withdrawals and point-of-sale debit card transactions. In addition, the proposal would have prohibited institutions from assessing overdraft fees where the overdraft would not have occurred but for a debit hold placed on funds in the consumer's account in excess of the actual transaction amount.

At the same time, the Board separately issued a proposal under Regulation DD and the Truth in Savings Act[4] which included form, content and timing requirements for providing the opt-out notice. That proposal would have required financial institutions to disclose to consumers aggregate totals for overdraft fees and fees for returning unpaid items, both for the statement period and year-to-date. In addition, if the institution quoted the customer's "available balance", it would have to exclude any funds that could be paid by means of an overdraft line of credit. These changes to Regulation DD were adopted in final form on January 29, 2009, and are scheduled to take effect on January 1, 2010.

The Board has decided not to issue its notification and opt-out rules relating to overdraft services pursuant to its Section 5 authority. We especially appreciate the Board's reconsideration of this issue. As we said in our comment to the original Regulation AA proposal, we believe that notification and opt-out provisions relating to overdrafts are disclosure issues, not issues relating to unfair and deceptive practices, and hence more appropriately addressed by amendment to other regulations relating to disclosure. We were especially concerned that prior acceptable overdraft practices by the industry could retroactively subject financial institutions to greatly enhanced litigation risk at the federal and state levels. We are extremely pleased that the Board has taken our concerns into account by moving to Regulation E its rules relating to overdraft services.

Discussion

First, the Proposal would clarify the relation between Regulation E and Regulation Z by providing that, for access devices that also constitute credit

[4] 73 Fed. Reg. 28730 (May 19, 2008)

cards, the rules of Regulation E apply if the only credit feature is a preexisting credit line attached to the asset account to cover overdrafts. Regulation Z would apply if there is another type of credit feature – for example, one permitting direct extensions of credit – that is separate and apart from the asset account. Furthermore, the addition of an overdraft service to an accepted access device would not constitute the addition of a credit feature subject to Regulation Z, and the account would be covered under Regulation E provided that no other credit feature was attached to the account. We agree with the Board's decision to clarify the respective relationships between Regulation E and Regulation Z by means of the above provisions.

The Proposal applies to any "overdraft service" for which a financial institution assesses a fee. It would not, however, include any payment of overdrafts pursuant to a line of credit where the financial institution is contractually liable to cover overdrafts, or a service that transfers funds from another account held by the consumer to cover overdrafts.

In addition, the Proposal would prohibit a financial institution from charging the consumer a fee for paying certain types of overdrafts – those generated by ATM withdrawals or one-time (i.e., point-of-sale) debit card transactions[5] ("ATM or POS Debit Card Transactions"), unless the financial institution provided the consumer with a notice and either an opt-in or opt-out. The remainder of this letter relates principally to overdrafts that are generated from ATM or POS Debit Card Transactions.

1. Opt-in or Opt-out. The Board requests comments as to whether it should adopt an opt-in or opt-out method for overdrafts.

The timing and content of the notices are similar, with a few small differences. Of course, one method would require the customer to notify the financial institution by opting-out if he did not want overdrafts paid, and the other would require the customer to opt-in if he did want overdrafts paid. One major difference between the two methods is that, for all opt-ins, the institution would have to provide the consumer with written confirmation of the consumer's consent to pay overdraft fees.

[5] This would include on-us and off-us ATM transactions and one-time debit transactions including PIN-based and point-of-sale transactions occurring in-store, online and by telephone, 74 Fed. Reg. 5217 (2009).

Citigroup believes it would be appropriate for the Board to implement the opt-out method. This method is consistent with many other consumer regulations that provide for opt-outs, such as privacy regulations under the Gramm-Leach-Bliley Act[6], regulations relating to affiliate sharing and affiliate marketing under the Fair Credit Reporting Act[7], the Telephone Consumer Protection Act[8] and FCC regulations issued thereunder[9], the CAN-SPAM Act[10] and the Junk Fax Protection Act.[11] Financial institutions are operationally and systemically familiar with opt-out methodologies and would not experience the disruptive effects of having to implement an entirely different approach.

Managing an opt-in program is costly and operationally burdensome. This is especially true since the opt-in program described in the Proposal would require the institution to provide the consumer with written confirmation documenting the consumer's choice. This would require institutions to create special back-office procedures simply to handle these opt-ins.

We believe that an opt-out program is no less effective as an opt-in program. Both require similar disclosures at similar points in time which allow the institution to include a customer service telephone number or e-mail address to which the customer may direct questions.

In addition, all consumers would receive the additional disclosures required by Regulation DD, mentioned above, that must contain: (i) overdraft fees charged during the period; (ii) overdraft fees charged year-to-date; (iii) fees for returned unpaid items charged during the period; and (iv) fees for returned unpaid items charged year-to-date. The opt-out approach provides the customer with the same amount of information as does the opt-in approach, and would save institutions the additional time and expense that would be involved in managing an opt-in program.

Finally, we believe that an opt-in approach could significantly inconvenience customers. Although Citigroup typically does not pay overdrafts generated from ATM or POS Debt Card Transactions, other

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[6] 15 U.S.C. § 6801 *et seq.*

[7] 15 U.S.C. § 1681(d)(2)(iii) and 15 U.S.C. § 1681s-3(a)(1), respectively

[8] 47 U.S.C. § 227 *et seq.*

[9] 47 C.F.R § 64.1200

[10] 15 U.S.C. § 7701

[11] Pub. L. No. 109-21, 199 Stat. 359 (2005), amending provisions of the Telephone Consumer Protection Act

institutions may, and we may decide to do so in the future. Customers who neglect to take the step to opt-in will not have overdraft protection on transactions which may have been paid by their bank in the past. The opt-in approach could also significantly impact small businesses, which will lose potential business unless a customer returns the following day to complete a transaction that was declined at point-of-sale due to a customer's failure to take the time and trouble to opt-in to paying overdraft fees.

2. Reasonable opportunity for opt-out. Proposed Section 205.17(b)(ii) provides that once a consumer has received an opt-out notice, the consumer must be given a "reasonable opportunity" to opt out of an institution's overdraft service for ATM and POS Debit Card Transactions. Proposed comment 17(b)-2 suggests that a "reasonable opportunity" would consist of a 30 day period after the consumer is provided the initial notice informing him of the opt-out right. We believe that the need for a 30 day period is misplaced for existing customers, who have presumably been receiving overdraft services for the duration of their account term, upon which fees may have been assessed. If the customer has been unhappy about the fees, presumably she has already taken greater control over her finances to avoid generating overdrafts. Nevertheless, she may appreciate occasionally receiving the overdraft service when she has inaccurately computed her available balance.

If the final rule requires the financial institution to wait 30 days after the mailing of the statement or notice to give an existing customer time to opt-out, the customer will be deprived of the opportunity to have overdrafts paid during that time. Furthermore, it would require banks to develop operations that compute the 30-day period for each customer, "freeze" overdrafts during that period, and then "unfreeze" them if the customer does not opt-out after 30 days. This seems unwarranted, especially since the customer is in control of whether he or she generates an overdraft that may trigger a fee.

3. Revocation of opt-out. The Board is requesting comment on whether, in addition to allowing consumers to revoke a prior opt-out "in writing or electronically", a financial institution may allow consumers to revoke opt-outs "orally, whether by telephone or in-person." We urge the Board to consider allowing a customer to opt-out by any of these methods - whether in writing, by email, by telephone or in person. This provides the most flexibility and convenience to both customers and financial institutions. The same is true for opt-ins.

4. Dynamic or static opt-out notice on billing statement.

As mentioned above, as of January 1, 2010, financial institutions will be required to comply with the newly adopted provisions in Regulation DD regarding disclosure of overdraft charges. This includes fees for all types of overdrafts, including those generated by check or ACH transfers, as well as the overdrafts covered by the Proposal – that is, overdrafts generated from ATM or POS Debit Card Transactions. As discussed above, this will require disclosures of overdraft fees and fees for returned unpaid items incurred during the period and year-to-date, in close proximity to other fees that must be disclosed under Regulation DD.

The Board is requesting comment on whether or not a financial institution should be permitted to include the opt-out notice on the periodic statement if he or she did not incur any overdraft fees or charges during the statement cycle. Although the Board recognizes that dynamic programming of the opt-out notice - so that it appears only when overdraft fees have been charged - could impose additional costs on financial institutions, it is concerned that consumers may dismiss the opt-out notice as boilerplate language if it were included on every periodic statement.

We believe that financial institutions should be permitted to display the opt-out as static on the periodic statement, whether or not the consumer was charged overdraft fees for the month, for a number of reasons.

First, a financial institution may want to lengthen the model form disclosures to explain the fact that the types of overdraft fees that may be aggregated on the statement are different from the types of overdraft fees with respect to which the customer has the right to opt-out. (Specifically, the overdraft fees that must be disclosed under Regulation DD are fees that relate to *all* forms of overdrafts, including those generated by check and ACH, although the right to opt-out relates only to fees generated by ATM or POS Debit Card Transactions.)

Although the model form does contain a sentence that explains this, a financial institution may believe it is necessary to elaborate on this explanation. To do so, it may need additional space outside the dynamic portion of the statement. Furthermore, if the financial institution chooses to condition the payment of a consumer's overdrafts generated by ATM and

POS Debit Card Transactions on the payment of other types of overdrafts, it will need additional space on the statement to explain this complex point to the customer.

Second, having the opt-out printed on every statement is beneficial to the consumer. Even if the consumer did not pay any overdraft fees during one particular statement period, they may decide to opt-out during that statement period. Having the opt-out form printed on all statements makes it much simpler for the customer to opt-out at any time.

Third, financial institutions will be incurring incremental programming costs to generate the disclosure of periodic and year-to-date overdraft fees and fees for returned unpaid items, pursuant to the recent revisions to Regulation DD. Adding an additional programming task to include further dynamic text could complicate the programming that has already been done, and will certainly result in additional programming costs.

Finally, we are not persuaded by the argument that customers may overlook the opt-out form if it always appears on the statement. Customers will always be notified of the overdraft charges and fees for returned unpaid items that they incur pursuant to the Regulation DD provisions described above. The continuous presence of the opt-out notice on the periodic statement will not make these customers any less concerned about fees they have incurred. If the notice is always on the form, the customer will be made aware every billing period of his right to opt-out, and how to do so.

5. Conditioning the opt-out or opt-in. The Board proposes allowing financial institutions to condition a customer's opt-out (or opt-in) relating to ATM and POS Debit Card Transactions on the customer opting out of other types of overdrafts – for example, overdrafts generated by check, ACH transactions, and recurring or one-time bill payment transactions. We agree that financial institutions should be allowed the flexibility of conditioning the more limited types of overdrafts on the consumer also opting out of (or opting-in to) the payment of all other overdrafts. However, we would like to make certain that this does not result in an "all or nothing" rule.

We believe that the Board is considering this alternative due to comments it received when it published the Regulation AA provision on overdrafts. Many financial institutions explained that their systems cannot separately identify overdrafts generated by ATM and/or point-of-sale debit card transactions from other types of overdrafts, such as those generated by check or ACH transfer.

Because the Board felt more strongly about limiting fees relating to ATM and POS Debit Card Transactions, the opt-out and opt-in provisions in the Proposal relates only to the narrower category of transactions. This is presumably because, when an overdraft occurs in connection with a check, ACH transfer or other bill payment (whether one-time or recurring), there are consequences beyond paying the bank's overdraft fee.

For example, if the bank does not pay a customer's overdraft, it will likely charge the customer a fee for a returned unpaid item. In addition, the merchant or other payee to whom the funds were payable is likely to charge a similar fee, and possibly late charges as well. Furthermore, the transaction which the customer wanted to complete will not be consummated and the customer could suffer significant consequences – for example, losing a bid on a home. None of these considerations are present when a bank declines an ATM transaction or point-of-sale debit card transaction – the worst that can happen is that the customer cannot immediately get money from the ATM or purchase the article they wished to purchase, but could do so the following day.

These valid considerations underlie the Board's decision to require an opt-out (or opt-in) only for ATM and POS Debit Card Transactions. We believe that financial institutions should be allowed to condition a customer's choice to pay some overdrafts on payment for all overdrafts - if it has systemic, operational or other reasons for requiring this. However, as stated above, we would not want this to become an "all or nothing" rule, since it benefits both the bank and the customer to retain as much flexibility as possible.

For example, if a financial institution does not distinguish between one-time point-of-sale payments and one-time debit card payments to merchants for bills already incurred (i.e., non-POS transactions), it should be allowed to couple these in the consumer's opt-out (or opt-in). If it does distinguish, however, between these transactions and all other overdrafts – such as those paid by check and ACH – then an "all or nothing" rule would work to the detriment of the customer, who may want the bank to pay overdrafts on checks and ACH transfers.

Consequently, we urge the Board to clarify that a financial institution may condition a consumer's right to opt-out of overdrafts relating to ATM and POS Debit Card Transactions on opting-out of other overdrafts which it does not distinguish from the former, but that such a rule would *not* require an "all or nothing" opt-out.

6. Other accounts without overdraft features on "identical" or "substantially similar" terms. The Board is concerned that customers who do not want overdrafts paid on their accounts will be eligible only for other accounts with "substandard" account terms and conditions. The Board asks whether it should require that financial institutions provide all customers "the same terms, conditions and features (except for the features that limit the payment of overdrafts)", or whether financial institutions should be allowed to vary the terms, conditions or features of an account that does not permit the payment of overdrafts on ATM or POS Debit Card Transactions.

We prefer the second option since it provides more flexibility for financial institutions and consumers. Consumers should be sufficiently protected if the Board adopts its proposed language that states that "the differences [may not be] so substantial that they discourage a reasonable consumer from exercising his or her right to opt out of the payment of such overdrafts."

7. Exceptions to notice and opt-out requirement. We agree that a financial institution need not honor a customer's opt-out (or opt-in) if it "has the policy and practice of declining to pay any ATM withdrawals or one-time debit card transactions for which authorization is requested if it has the reasonable belief that the consumer's account does not have sufficient funds available to cover the transaction at the time of the authorization request."

We also agree with the Board's second exception, which provides that the rules would not apply to a financial institution that requires consumers to affirmatively consent to the institution's overdraft service for the payment of any ATM or POS Debit Card Transactions before the institution assesses any fees for paying the overdrafts.

This exception would presumably include a situation where a financial institution displays an ATM screen when a customer does not have sufficient funds to make a withdrawal or transfer, which informs the customer that the bank will pay the funds and charge a stated fee if the customer hits the "yes" button.

It would also include a situation where a merchant calls the customer's bank because of the bank's failure to authorize a point-of-sale purchase, and the bank informs the customer that it will pay the transaction if the customer wishes to pay its stated overdraft fee. We believe these exceptions are important to consumers, and a consumer's ability to have overdrafts paid in this manner should not be compromised by the Proposal if the financial institution did not previously provide the consumer with an opt-out notice.

We believe, however, that there should be a third exception. That is, where a financial institution does not issue an opt-out notice, pays an overdraft generated by an ATM or POS Debit Card Transaction, and waives its fees. This is an important exception for financial institutions that provide services to affluent customers.

8. Exceptions to the fee prohibition. The Proposal provides that, notwithstanding a customer's election to opt out, a financial institution may assess a fee on a consumer's account for paying an ATM or POS Debit Card Transaction if:

- the institution has a "reasonable belief" that there are sufficient funds available in the consumer'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.

We agree with these exceptions, but disagree with the Board's decision with respect to the treatment of small-dollar transactions not submitted to the financial institution for authorization. The Board provides an example of a customer purchasing a $3 cup of coffee using his debit card, and states that the customer should not have to pay overdraft fees for an overdraft relating to such a small transaction.

This position does not take into account card association rules relating to small-dollar transactions, which allow the merchant to accept the item without preauthorization from the customer's financial institution. Even though it had no opportunity to authorize the transaction, the financial institution is required to pay the item, whether or not it generates an overdraft in the customer's account.

In other situations, the Board has acknowledged that, where a financial institution has no opportunity to decline the transaction – for paper-based transactions, for example, that are not promptly submitted to the financial institution for payment – an exception to the general rule is appropriate, and the financial institution may charge an overdraft fee regardless of whether the customer opted-out (or chose not to opt-in) regarding the payment of overdrafts. We see no difference for small-dollar transactions, and do not believe we should be unable to charge a fee for a service we perform simply because the transaction is "small." "Small" transactions, as we all know, can add up.

The consumer is in the best position to determine whether he has sufficient money in his account to pay for the coffee or other small item. By being assessed overdraft fees, he will be incented to act responsibly and not charge items unless he has sufficient funds to pay for them, whether by debit card, credit card or cash.

9. Debit Holds. The Proposal states that a financial institution may not assess an overdraft fee if "the overdraft would not have occurred but for a hold placed on funds in the consumer's account in connection with a debit card transaction if the actual amount of the transaction can be determined by the merchant or other payee within a short period of time after the financial institution authorizes the transaction."

There is a Safe Harbor that would allow the financial institution to charge a fee if the institution maintains "procedures and practices" designed to release a debit hold within a reasonable period of time, such as where the institution "releases the hold within two hours of the institution's authorization of the transaction."

The rule is intended to capture transactions in which the actual transaction amount can be determined within a short period of time after the institution provides the initial authorization for the transaction, such as gasoline purchases and restaurant charges. For example, when a customer purchases gasoline, the merchant typically requests a pre-authorization hold of $1 from the financial institution, to make certain that the card is valid. The financial institution may increase this hold to $75, in accordance with card association rules. When the transaction is complete, the merchant presents the transaction for settlement. Although this typically occurs in the same day, it can take up to three days for the merchant to submit the item for settlement. Until the item is finally settled, the bank continues to maintain the $75 hold.

For these short-term transactions, the Proposal suggests that the financial institution must "look back" to determine whether the $75 hold, if it exceeded the amount of the final transaction, caused an overdraft that would not have occurred but for the excess amount of the debit hold. Significant systems changes would be needed to allow us to analyze transactions that could have had an impact on an account's overdraft status and determine if the overdraft would not have occurred but for the hold that exceeded the final settlement amount. We believe such a rule would place a significant burden on other financial institutions as well.

Instead, we believe that a combination of rules should be adopted that relate to prompt processing by both merchants and financial institutions. For example, card association rules could be modified to hold the merchant responsible for promptly notifying the financial institution of the final amount of the transaction. We understand from the Proposal's preamble that some associations are considering such rules.

Second, we agree that, in order to charge an overdraft fee, a financial institution should maintain "procedures and practices" designed to release a debit hold "within a reasonable period of time". However, we do not consider "two hours" to be an appropriate yardstick, and suggest that the actual language in the Proposal – "within a reasonable period of time" – be used as the actual standard.

10. Effective Date. The Board is aware that financial institutions are presently dedicating systems and operational resources to address revisions to Regulation AA, Regulation Z and Regulation DD. We do not believe this proposal warrants a reduction in those initiatives. Therefore, due to the incremental systems and operational implications that would be posed to financial institutions by the Proposal, we ask the Board to consider no less than a 24-month implementation period

We appreciate the opportunity to comment on the Proposal. If you have any questions relating to these comments or would like to discuss them in greater detail, please call me at (212) 559-2938 or Joyce Elkhateeb at (212) 559-9342.

Sincerely,

Carl Howard

cc: Joyce ElKhateeb
Viola Spain