



March 31, 2010

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

RE: Docket No. R-1343

Dear Ms. Johnson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions, I would like to respond to the Federal Reserve Board's (the Board) request for comment on proposed changes to Regulation E and Regulation DD, regarding overdraft protection. NAFCU generally supports the amendments to Regulation E and Regulation DD as they will help clarify some ambiguities from the Board's recent amendments regarding overdraft protection. However, NAFCU remains concerned regarding the scope of § 205.17(b)(1) and (b)(4) as it relates to institutions that have a policy and practice of declining transactions when the institution reasonably believes there are insufficient funds at the time authorization is requested. Additionally, we have one other concern that is more technical in nature.

The proposed changes to §205.17(b) make clear that institutions are prohibited from assessing an overdraft fee if the consumer has not opted in, even in cases where a transaction, approved on sufficient funds, ultimately settles in to insufficient funds. NAFCU understands that there were some abuses regarding overdraft protection that the Board has rightfully addressed. Nonetheless, given that financial institutions cannot possibly have real time knowledge of all of a consumer's purchases, the rule should provide a narrow exception in instances where institutions approve a transaction when adequate funds exist and are then contractually obligated to pay that transaction at a later date when there are insufficient funds available.

NAFCU believes the Board's recent proposed changes to Regulation Z regarding penalty fees can serve as a useful template for overdraft fees. *See Truth in Lending*, 75 Fed. Reg. 12334, 12343-12347 (March 15, 2010) (to be codified at 12 C.F.R. pt. 226). In most situations, an institution would remain prohibited from assessing an overdraft fee on consumers who have not opted in. However, in cases where an approved transaction settles in to insufficient funds, the

March 31, 2010

Page 2 of 3

institution should be authorized to assess a fee, determined by the Board as “reasonable and proportional” to the violation. Alternatively, the institution could be authorized to assess a fee that equals the amount of the overdraft. Just as the Board outlined in its recent proposal on Regulation Z, the institution would be required to charge the lesser of the two potential overdraft fees. Given that the Board has recently proposed this structure for penalty fees on credit cards, NAFCU believes implementing a similar fee structure for overdraft penalties in this narrow circumstances is reasonable.

Another solution may be to allow institutions to assess sustained overdraft fees in this situation if the account remains at a negative balance for an extended period of time. For example, if, after five days, the account remains negative, the institution may then charge a fee equal to the amount of the overdraft or a safe harbor fee, determined by the Board.

NAFCU understands that the Board is concerned that consumers who have not opted-in may reasonably expect that ATM or one-time debit transactions will be declined if there are insufficient funds. However, that concern can be remedied through proper disclosures that explain an overdraft fee may be assessed when a previously approved transaction settles in to insufficient funds. Further, that concern should be balanced against the cost to institutions of honoring these transactions and the potential unintended consequences this rule will create for all consumers. There are real costs and risks involved for institutions when they pay out transactions where there are insufficient funds. The rule as it is now written, however, does not consider those costs.

Moreover, the strict prohibition on overdraft fees in these instances will create unintended consequences for all consumers. The amendments to § 205.17(b) of Regulation E require institutions to offer the same account terms, conditions and features to all consumers, regardless of whether they opt in to overdraft protection. Electronic Fund Transfers, 74 Fed. Reg. 59033, 50953 (Nov. 17, 2009) (to be codified at 12 C.F.R. pt. 205). Previously, the costs and risks created by overdrafts were borne by those individuals who overdrew their accounts. This rule, however, will require institutions, in at least some situations, to spread those risks and costs across all consumers. Consequently, all consumers will likely see changes in their accounts. For example, institutions may examine a consumer’s history much more closely in order to determine whether to even offer the individual a debit card. Likewise, to protect against paying transactions where there are insufficient funds, institutions may increase the minimum balance on all consumer accounts. NAFCU does not expect the Board to reconsider its overarching policy on overdraft protection. Nonetheless, a narrow exception to the general rule to allow for a fee in cases where institutions are contractually obligated to pay a previously approved transaction, when there are insufficient funds available, would be fair and equitable to all parties involved.

In our estimation, the justification for this strict prohibition rests on two faulty assumptions. First, the rule presumes that there is little if any cost to financial institutions for paying these transactions (and also no apparent benefit to the consumer). Second, as the Board made clear in the amendments to Regulation E, it believes “financial institutions are in a better position [than consumers] to mitigate the information gap” when it comes to determining the account balance at the time of a transaction. *Id.* at 59046. This statement mischaracterizes the role of financial institutions in the process. Specifically, The Board ignores the function that

March 31, 2010

Page 3 of 3

merchants and the card companies play in the process. Many merchants, for a number of reasons, do not process transactions until the end of the business day. Consequently, credit unions have no way of knowing what purchases a consumer may have made. Moreover, credit unions – like most other institutions that issue debit cards – are far removed from the relationship between the card companies and the merchants. Credit unions also have, relatively speaking, a very small segment of the card market. Thus credit unions have no role and no leverage in encouraging merchants to process transactions in real time. Accordingly, NAFCU recommends the Board consider the tools it has at its disposal to require merchants to process transactions in real time. Simply put, without merchants processing transactions in real time, financial institutions have little, if any, opportunity to mitigate the information gap.

Additionally, financial institutions do not have any way of knowing what checks a customer has written, which obviously can lead to a previously approved transaction settling in to insufficient funds. In closing, NAFCU believes the Board should reevaluate the policy rationale for this rule and consider a narrow exception in cases where an approved transaction settles in to insufficient funds. An exception in these instances will help protect financial institutions from the real costs and risks associated with paying such transactions, and it will help ensure that the rule's unintended consequences do not negatively affect all consumers.

There is one other technical issue which has come to NAFCU's attention, regarding an ambiguity in the model disclosure form, A-9. While this issue was not mentioned in the proposed rule, I would encourage the Board to address the matter in the final rule. The model form explains that the institution's standard overdraft practice does not include paying "[e]veryday debit card transactions". Id. Some members have expressed concern that the meaning of this statement may not be clear to all consumers. Accordingly, it may be helpful to clarify what is meant in this case. For example, it may help to amend the sentence to read "Everyday debit card transactions (one-time transactions)" or "Everyday debit card transactions (one-time, point-of-sale transactions)". This is a minor concern; nonetheless, we believe it would be useful, going forward, to clarify this matter.

NAFCU appreciates this opportunity to share its comments on the proposal. Should you have any questions or require additional information please call me at (703) 842-2212.

Sincerely,

A handwritten signature in black ink, appearing to read "Dillon Shea". The signature is written in a cursive, slightly slanted style.

Dillon Shea
Associate Director of Regulatory Affairs