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August 6, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Ave., NW
Washington, D.C. 20551
Attention: Docket No. OP-1198

Office of the Comptroller of the Currency
250 E Street, S.W.
Public Information Room, Mail Stop 1-5
Washington, DC 20219
Attention: Docket No. 04-14

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Attention: Docket No. 2004-30

Re: Proposed Interagency Guidance on Overdraft Protection Programs
7 June 2004 *Federal Register*

Dear Ms. Johnson,

The American Bankers Association ("ABA") is pleased to submit its comments to the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and the National Credit Union Administration ("the Agencies') on their proposed Interagency Guidance on Overdraft Protection Programs. The proposed Guidance is intended to assist insured depository institutions in the responsible disclosure and administration of overdraft protection services.

The ABA brings together all elements of the banking community to represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

Background.

The Agencies have developed the proposed Guidance to address services offered by banks and other depository institutions commonly referred to as “bounced-check protection.” These programs are, in essence, a variation on the traditional practice of paying customer overdrafts under certain circumstances. The proposed Guidance points out that these newer programs differ from traditional practices in that they are marketed to consumers and typically disclose to consumers an overdraft limit. The proposal is intended to address aspects of the newer programs that have raised concerns with the Agencies. The proposed Guidance is divided into three sections: Safety and Soundness Considerations, Legal Risks, and Best Practices.

Discussion.

ABA generally agrees with much of the proposed Guidance. Many of the recommendations are appropriate and fair and will help ensure that consumers understand overdraft policies and fees. Many reflect ABA’s own suggestions to its members, provided in a variety of media. This includes a March 31, 2003 letter to all ABA members that dealt exclusively with bounced check programs. ABA also developed with Alex Sheshunoff Management, a provider of bounced check programs, “Overdraft Protection: A Guide for Bankers,” a brochure that explains such programs, identifies potential risks, and offers “best practices.”

While we generally agree with the proposed Guidance, we believe that the agencies’ Guidance will only be useful so long as it is not misinterpreted as mandatory or that failure to comply with one or more of the guidelines is necessarily deemed to be unfair or deceptive. This should be made clear in the final Guidance. In addition, we suggest that the Agencies address several internal inconsistencies and improve the clarification of the distinctions among the various practices and programs so there is no question that the Guidance addresses only programs that disclose a discretionary limit. The Guidance should also recognize the discretionary nature of overdraft payments and not classify discretionary limits as “commitments” nor require the disclosure of instances when the overdraft will not be paid. We have also made suggestions to specific sections of the Guidance.

Introduction of Proposed Guidance.

The description of “overdraft protection program” is confusing and should clarify that the Guidance only applies to programs that are “promoted” and disclose a specific discretionary limit. The Introduction of the proposal strongly suggests that the Guidance is intended to only cover certain types of "overdraft protection" programs. It states:

> Unlike the discretionary accommodation traditionally provided to those lacking a line of credit or other type of overdraft service. . . these overdraft protection programs are *marketed* to consumers essentially as short-term credit facilities, and typically provide consumers with an *express overdraft limit* that applies to their accounts. (Emphasis added.)

The proposal also lists a variety of characteristics attributable to such programs, including that the banks inform consumers of the feature, including the discretionary limit and promote its use. The Agencies also express their concerns that the program is promoted as credit; that some institutions appear to encourage overdrafts; and that promotions may lead consumers to believe that overdrafts will automatically be paid when the bank retains discretion not to pay overdrafts. Thus, it appears that the Agencies are attempting to address overdraft protection programs that are promoted and for which the discretionary limit is disclosed.

However, the Guidance could apply to traditional practices, albeit automated, of paying overdrafts on a discretionary basis where the practice is not promoted nor the discretionary limit disclosed. For example, the proposal includes as a characteristic of a covered overdraft protection program a disclosure that the bank may pay an overdraft, but has no legal obligation. This is standard deposit agreement language required in order for the bank to pay an overdraft. That a flat fee is charged for each overdraft and is the same as if the item were not paid would also indicate that the program is covered. Again, this is common practice for all institutions.

The Agencies should make clear that the Guidance refers only to those programs that are promoted and for which the discretionary limit is disclosed, which appears to be their target. While many banks have automated the traditional practice of paying overdrafts on a discretionary basis, it is a little different from providing the same courtesy manually, except that it is more efficient and less subjective. There appears to be little complaint or concern about these practices to justify imposing new unnecessary regulatory burdens. In any case, the Guidance should not focus on whether the program is "automated" or not. Such a distinction is artificial, confusing, and meaningless.

Safety and Soundness Considerations.

We agree with the Agencies that institutions should address the operational and other risks associated with paying overdrafts. We also agree with the suggestion that management practices include the establishment of “express account eligibility standards.” However, the Agencies should clarify that such standards need not include typical underwriting standards where “creditworthiness” is evaluated. While it varies from bank to bank, whether or not they promote their program or disclose the discretionary limit, banks rely on a variety of criteria such as the average daily balance, the age of the account, whether regular deposits are being made, for example. Criteria are not, for example, based on whether the customer has filed bankruptcy or not repaid a loan, as the Guidance suggests. No underwriting is done. Decisions are not based on external influences. No credit reports are reviewed. Otherwise, overdrafts would only be paid for accountholders with good credit history. The rest would have to suffer the adverse consequences of bounced checks.

The Agencies also recommend that institutions “monitor these accounts on an ongoing basis and be able to identify individual consumers who may be excessively reliant on the product or who may represent an undue credit risk to the institution.” We agree that banks should monitor for any undue risk to the institution and for abuses. We object, however, to the recommendation that the bank monitor accounts to identify those who are “excessively reliant” on the product. “Excessively reliant” is too vague to provide guidance. Moreover, while large institutions that do not promote or disclose their discretionary limits monitor accounts to detect large overdrafts as a matter of safety and soundness, they do not flag low dollar overdrafts or frequency of overdrafts. As a practical matter, these factors do not pose safety and soundness issues. To require such monitoring would require extensive new systems and is not justified, given that low dollar overdrafts generally do not pose safety and soundness issues. If the suggestion is retained, it should make clear that it is only necessary if there is a valid safety and soundness issue.

The proposal includes the suggestion that banks establish specific timeframes for repaying the overdraft balances. The Agencies should make clear that “Due immediately,” “Due upon receipt,” and similar language is acceptable. This is a common requirement.

The proposal notes that overdraft balances should generally be charged off within 30 days from the date of the first overdraft. We strongly recommend that the time be extended to at least 60 days. This will benefit consumers. Once the balance is charged off, banks report the negative information to consumer reporting agencies. This may mean that the consumer will have difficulty in opening an account in the future. However, a large percentage of overdrafts are cured between 30 and 60 days after the date of the overdraft. Allowing a little extra time will mean fewer consumers will suffer adverse reports. Moreover, the bank is more likely to be repaid: the consumers’ incentive to repay decreases once the adverse information has been reported.

The proposal recommends procedures for suspension of overdraft services when the customer no longer meets the eligibility criteria and supplies as examples bankruptcy or default on another loan. As discussed earlier, these are not and should not be typical criteria for determining eligibility for overdraft payment. Otherwise, only the most creditworthy customers would qualify. Moreover, banks may not know that the customer has filed bankruptcy or defaulted on a loan, as credit reports are not reviewed, neither initially nor periodically.

The proposal provides, "When the bank routinely communicates the available amount of overdraft protection to depositors, these available amounts should be reported as "unused commitments" in regulatory reports." We strongly object to this language and recommend its deletion. The discretionary limits are neither "available" nor "commitments," either by agreement with the customer or under the proposed Guidance.

Banks choosing to pay overdrafts generally reserve the right not to pay and under a variety of circumstances, do not pay. Unlike overdraft lines of credit, the bank has no obligation to pay an overdraft. Indeed, ABA has worked with the industry to ensure that banks are not misleading consumers into believing that overdrafts will "automatically" be paid. Classifying them now as "commitments" sends the wrong message and will confuse banks about their obligations. If they are commitments, must the bank pay? May the bank then inform customers that certain overdrafts will automatically be paid?

This message contradicts the proposed Guidance, which insists that banks must make clear to customers that the bank is not promising to pay. It recommends, "[I]f payment of overdrafts is discretionary, information provided to consumers should not contain any representations that would lead a consumer to expect that the payment of overdrafts is guaranteed or assured."

Best practices.

Avoid promoting poor account management. We agree with this suggestion.

Fairly represent overdraft protection programs and alternatives. This section states:

> When informing consumers about an overdraft protection program, inform consumers generally of other available overdraft services or credit products, explain to consumers the costs and advantages of various alternatives to the overdraft protection program, and identify for consumers the risks and problems in relying on the program and the consequences of abuse.

The provision should make clear that the bank need only inform consumers about alternatives the bank actually offers. "[T]hat the bank offers" should be added after "credit products."

In addition, the provision should make clear that "informing consumers about an overdraft protection program" does not include a notation on a statement of the discretionary limit. Adding such extensive information on the statement will obscure more important information.

Clearly explain discretionary nature of program. We agree that if payment of overdrafts is discretionary, information provided to consumers should not contain representations that would lead a consumer to expect that the payment of overdrafts is guaranteed or assured. Our communications to banks have so recommended.

However, we disagree that the bank should describe the circumstances in which the institution would refuse to pay. There are numerous and ever-changing reasons why the bank may refuse to pay. Many banks do not disclose those reasons because they do not want fraudsters to take advantage of the system. Moreover, requiring disclosure means that even though there may be a justified reason not to pay, the bank will be obligated to pay if that reason was not specifically disclosed. Furthermore, listing the reasons for not paying implies a commitment to pay absent one of those enumerated reasons. This means that payment is no longer discretionary, implicating other regulations such as Regulation Z.

Clearly disclose program fee amounts. We agree with the recommendation to clearly disclose the dollar amount of any overdraft protection fees and any interest rate or other fees that may apply.

Explain check clearing policies. We strongly object to the recommendation that banks "[c]learly disclose to consumers the order in which the institution pays checks or processes other transactions, (e.g. transactions at the ATM or point-of-sale terminal)." This section should be deleted.

The order of payment is a very complex system that is virtually impossible to explain in a manner understandable to most consumers. The explanation could take several pages. In a system with multiple and varied payment mechanisms, it is not simply a question of paying "high to low." One bank reported some 29 potential scenarios. Some items take priority and must be "force posted." For example, electronic transactions generally take priority because they are assumed to settle the next day. Even among electronic payments, priority may vary. For example, banks may have to pay a debit card transaction that needed no prior approval because it fell below the required threshold. Moreover, even banks that rely on automated systems will still review transactions manually. In those cases, a bank may give priority to important transactions such as mortgage and insurance premium payments. Finally, many banks are conscious that fraudsters attempt to learn the bank's system in order to use the knowledge to commit fraud. For these reasons, many banks disclose that they pay items in the "order we choose" to avoid liability and ensure necessary flexibility.

We see no value in trying to explain a complex system that customers will simply not understand or be able to use. Even if they understand the order, they cannot know when a check or other transaction will actually reach their bank.

Illustrate the type of transactions covered. The proposal notes that banks should clearly disclose that overdraft protection fees may be imposed in connection with transactions such as ATM withdrawals, debit card transactions, etc., if applicable. We strongly agree with this recommendation. It is critical that consumers understand that a transaction may be approved under these circumstances, a message we have relayed in our communications to members.

Program Features and Operation.

Provide election or opt-out of service. The Agencies suggest that banks "[ob]tain affirmative consent of consumers to receive overdraft protection." We strongly recommend deletion of this recommendation for the sake of consumers.

Whether or not specifically informed, many consumers are aware, based on experience, that their bank may pay overdrafts on an occasional basis. Indeed, consumers with long-standing relationships and little history of overdrawing, expect and want the bank to pay an accidental overdraft. This represents most customers. Aware of the bank's practice, they may glance at and then discard a notice to opt-in, on the basis that they believe that they are already covered for that occasional overdraft, or they may mistake the program for an overdraft line of credit that they do not need or want. They are then furious when they inadvertently overdraw and the bank returns the check. A typical response is, "Why did the bank return the check? I have been a good customer for years and have rarely overdrawn. In the past they paid them when I made a mistake." We believe that a system of opting in, particularly if the final Guidance covers banks that do not advertise their policies or disclose the discretionary limit, will be detrimental to consumers.

Alert consumers before a non-check transaction triggers any fees. The proposal suggests that banks alert consumers "where feasible" that completing a transaction using means other than a check will trigger a fee. We agree, assuming that “where feasible” is retained. In many cases, especially with point-of-sale and ATM debit card transactions, it is not always possible to know whether a fee will be assessed. For example, if a point-of-sale transaction amount is under the approval threshold, the bank will not know of the transaction nor that the account will overdraw. Even if known, it may not be operationally possible to relay the information.

Prominently distinguish actual balances from overdraft protection funds availability. While we generally agree with this concept, it may not be feasible in some cases. Our understanding is that in order to make the additional amount available, in some cases, e.g., at an ATM, the system must combine the actual funds available and those funds available through the overdraft program. Accordingly, the final Guidance should insert “where feasible” after “by any means.”

Consider daily limits. The proposal recommends that banks consider limiting the number of overdrafts or the dollar amount of fees that will be charged while continuing to cover overdrafts up to the limit. This is acceptable so long as the bank may do so on an individual account basis rather than necessarily as a strict policy. Most banks today may limit fees or waive them when multiple overdrafts occur as a single incident. However, consumers can abuse such policies. Accordingly, it should be clear that banks may use their discretion and make individual decisions.

Monitor overdraft protection program usage. The proposed Guidance advises banks to monitor excessive consumer usage and inform consumers of alternative credit arrangements. As noted earlier, many large institutions that do not promote or disclose their discretionary limits monitor accounts to detect large overdrafts as a matter of safety and soundness. However, they do not flag low-dollar overdrafts or frequent overdrafts. Setting up a system to monitor would pose significant costs and effort for banks with millions of accounts, for the sake of the small percentage who overdraw frequently. Accordingly, if the final Guidance includes institutions that do not promote or disclose the discretionary amount, it should exclude those institutions from this provision.

Conclusion.

The ABA appreciates the opportunity to comment on this important proposal. We believe that generally, the proposed Guidance moves in the right direction, so long as it is clear that it is should not be interpreted or applied as a requirement. We agree with many of the specific proposed suggestions. However, we strongly recommend that the final Guidance apply only to programs that are promoted and disclose a specific discretionary limit. In addition, the Agencies should emphasize the discretionary nature of most overdraft payments and not confuse the matter by labeling discretionary limits as commitments or requiring disclosures explaining when payments will not be paid.

Regards,

Nessa E. Feddis

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