Sam Davis
President
sdavis@strunklp.com

June 18, 2008

Jennifer J. Johnson
Secretary
Agencies of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington D.C. 20551

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, D.C. 20552

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

RE: PROPOSED AMENDMENTS TO REGULATION AA, DOCKET NO. R-1314

Dear Ms. Johnson; Chief Counsel's Office of the OTS; and Ms. Rupp:

We appreciate the opportunity to comment on the proposed amendments[1] to Regulation AA[2] issued by the Board of Governors of the Federal Reserve System ("Board"), in conjunction with the Office of Thrift Supervision ("OTS") and the National Credit Union Administration ("NCUA") (or, collectively, "the Agencies"). For almost 15 years, Strunk & Associates has consulted with banks, thrifts and credit unions throughout the country in connection with Strunk's Overdraft Privilege℠ Service ("OPS") and Occasional Overdraft Privilege Service ("OOPS!"™); collectively the Strunk "Program" or "program"©. With over 1,500 active financial institution clients of all charter types nationwide – who collectively have *over twenty-five million (25,000,000) consumer checking, or share draft checking, accounts* participating in the program – we have a tremendous amount of experience in overdraft protection/payment services. We share the Board's concerns with the practices of some in the industry that may have misled consumers with respect to the true nature of discretionary overdraft protection services, and we applaud the Board's efforts to ensure that consumers not only have a substantive right to opt out of overdraft protection services, but also receive adequate notice of that right. And while we agree with many provisions of the Proposal, we have concerns about some of the specifics contained therein. We hope that our comments will be useful. Our comments on the Proposal are set forth below and are identified by the title of the section of the Proposal to which they relate.

[1] 73 Fed. Reg. 28904 (May 19, 2008) ("Proposal").
[2] 12 C.F.R. Part 227 ("Regulation AA").

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595

Sam Davis
President
sdavis@strunklp.com

Consumer Right to Opt Out

General Opt-Out Rights. The centerpiece of the Proposal is the creation of a substantive right for consumers to opt out of "overdraft services," which the Proposal defines as "a service under which an institution charges a fee for paying a transaction (including a check, point-of-sale debit card transaction, ATM withdrawal and other electronic transaction[s], such as a preauthorized electronic fund transfer or an ACH debit) that overdraws an account."[3] The substantive opt-out right will prohibit financial institutions from charging any fees for providing overdraft services until the institution has provided consumers with (1) notice of his or her right to opt out and (2) a reasonable opportunity to exercise that right. The Proposal further includes a requirement that all depository institutions offer additional opt-out notices "at least once during or for each periodic statement cycle in which any overdraft fee or charge is assessed."[4] We agree with the Agencies that consumers are entitled to receive a meaningful opportunity to opt out of services that they do not want.

For this reason, we have always counseled our clients to allow customers to opt out of the types of overdraft services described in the Proposal. However, we believe that two concepts discussed in this section of the Proposal are either unclear or misguided. First, after the consumer receives an initial opt-out notice, the Proposal would not allow financial institutions to impose an overdraft service fee until the consumer has a "reasonable" time to opt out. We believe that the final version of the Proposal explain the Agencies' view of what constitutes a "reasonable" amount of time to opt out. Our concern is that the Agencies' (or examiners') view of reasonableness may differ from a financial institution's view of reasonableness. For example, if, upon opening an account, a consumer is given adequate notice of his or her right to opt out of overdraft protection services and elects not to opt out, then the financial institution would probably consider its obligation to provide a reasonable opportunity to opt out to be satisfied. However, the relevant regulatory agency could consider that time frame to be insufficient, preferring instead to give the consumer a few days to think it over. The final rule would be more useful if it included a more detailed explanation of how much time must pass between the initial opt-out notification and the assessment of overdraft service fees.[5]

We are also concerned with the Proposal's requirement that additional opt-out notices be provided at least once during every statement period in which the consumer incurs an overdraft service fee. We believe that providing an opt-out notice, which will in most cases be accompanied by an explanation of the potential harms that might result from the consumer's decision to opt out, would simply bury consumers with information. Instead, we recommend that a concise statement of the consumer's right to opt out be placed on the consumer's periodic statement in close proximity to the aggregate fee disclosures mandated by 12 C.F.R. Part 230.11.

---

[3] 73 Fed. Reg. at 28928.
[4] *Id.* at 28929.
[5] We also agree with the provision in the proposed amendments to Regulation DD that would not require financial institutions to provide an opt out notice to accounts opened before the amended regulations become effective. *See id.* at 28743. We do, however, recognize that requirement to provide subsequent opt-out notices would apply to all accounts.

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595

Sam Davis
President
sdavis@strunklp.com

Then, the institutions could mail a separate, full-length opt-out notice on a less frequent basis—perhaps annually or bi-annually. Such an approach would ensure that consumers are aware of their opt-out rights without requiring them to sift through mountains of information on their periodic statements.

Partial Opt-Out Rights. In addition to creating a substantive right to opt out of overdraft services, the Proposal creates a partial opt-out right that would allow customers to opt out "only of the payment of overdrafts at ATMs and for debit card transactions at the point-of-sale."[6] The Proposal sets forth the rationale for creating the partial opt-out right: "While the payment of overdrafts may allow consumers to avoid merchant fees for a returned transaction, there are no similar consumer benefits for ACH withdrawals and point-of-sale debit card transactions."[7] It may be true that a consumer whose point-of-sale (POS) debit payment is denied will not incur the standard insufficient funds charge that would accompany a returned check. But such a simplistic analysis ignores the non-monetary consumer benefits conferred by a comprehensive overdraft protection services program.

Consider a working mother who, along with her small children, after spending two hours shopping for groceries, swipes her debit card at a card terminal in the grocer's check out line only to have her payment authorization denied due to insufficient funds. Without an overdraft protection program, she will be forced to either return some of the merchandise, attempt to pay with a check (which may be returned) or pay with a credit card, piling additional charges onto what might already be a large outstanding balance. In that situation, the working mother may place a high value on the convenience and avoidance of embarrassment offered by her financial institution's overdraft protection program. If her choice is between incurring an overdraft service charge or adding to an outstanding credit card balance, it may be much cheaper in the long-run for her to incur the overdraft service fee. We are puzzled over why the analytical framework supporting the Proposal's partial opt-out regime pays no attention whatsoever to those benefits.

Not only would the Proposal's partial opt-out regime ignore the convenience benefits provided by overdraft services, it would also prove confusing and expensive. Although it creates a partial opt-out option for POS debit-card transactions, the Proposal does not explain which debit transactions it would classify as POS transactions. For instance, the Proposal does not indicate whether other debit transactions, such as online purchases, PC banking transactions, recurring and automatic bill payments, and over-the-phone transactions would be considered POS debit card transactions or some other type of transaction. Even ATM transactions create some confusion, since the Proposal does not indicate whether ATM transactions that do not involve a cash withdrawal, such as loan payments initiated by a consumer at an ATM or an inter-account funds transfer, would be subject to partial opt out. Any inconsistency in treatment among the various types of debit card transactions will generate confusion among consumers and financial institutions.

[6] *Id.* at 28930.
[7] *Id.* at 28929.

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595

Sam Davis
President
sdavis@strunklp.com

Even if the Agencies clarify which transactions are considered POS debit card transactions, we believe it will be exceedingly difficult to educate consumers about the types of transactions subject to partial opt out. It will be exceedingly difficult to help the consumer understand why an online purchase or a recurring online bill payment would not be subject to partial opt out. And even if the consumer understands the scope of the partial opt out when it is explained to him or her for the first time, there is no guarantee that the customer will retain that understanding.

The implementation of a partial opt-out program will also be expensive. As the Proposal acknowledges, "some processors do not currently have systems capable of paying overdrafts for some, but not all, payment channels." And even those processors that do possess the capabilities will incur substantial programming costs to implement the partial opt-out program. Instead of requiring financial institutions (and ultimately, consumers) to incur such steep costs, we urge the Agencies to rely on the Proposal's comprehensive opt-out right and increased disclosure requirements to improve the uniformity and effectiveness of consumer understanding.

Exceptions. The Proposal creates two exceptions to the general rule that financial institutions cannot impose a charge for paying an overdraft created by a customer who has opted out of the institution's overdraft payment program. The two exceptions consist of the following: (1) situations where an overdraft occurs as a result of a POS debit card transaction, and the purchase amount presented for settlement by a merchant exceeds the amount that was originally requested for pre-authorization; and (2) situations in which a merchant, without first obtaining authorization from a card issuer, presents a debit card transaction for payment by paper-based means, and the amount of that transaction creates an overdraft. We agree that in both of these situations a financial institution should not be subject to a consumer's opt-out decision because there is no effective method for a financial institution to decline to pay the item beforehand.

Debit Holds

The Proposal would prohibit a financial institution from assessing an overdraft fee if (1) the overdraft is caused solely by a hold placed on funds as the result of a debit card transaction, (2) such hold exceeds the actual purchase amount of the transaction, and (3) the actual purchase amount would not have caused the overdraft. The Proposal would not prohibit institutions from assessing an overdraft fee if the consumer's account has insufficient funds to cover the actual purchase amount when the transaction is presented for settlement (and the consumer has not opted out).

We recognize that there is no simple solution for the Agencies that would allow them to produce a sound regulation that is agreeable to all parties. However, in its current form, the Proposal ignores or disregards the realities of providing overdraft services in an economy that depends increasingly on debit transactions. First, the Proposal disregards that overdraft services are just that: services. Our client experiences consistently reinforce the idea that consumers value the convenience offered by overdraft protection services, and that they are willing to pay a fee for that convenience.

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595

Sam Davis
President
sdavis@strunklp.com

Second, for reasons explained in more detail below, the increased disclosure of overdraft service costs established by the Proposal, with its attendant call for more frequent opt-out notices, should offer an effective mechanism for balancing consumer protection concerns with the realities of everyday banking.

If our understanding of the Proposal's debit-hold rules is correct, it would allow a financial institution to assess an overdraft fee only if the amount of the transaction ultimately presented for payment would have caused an overdraft to occur *at the time of the original transaction*. That proposition, simple in theory, would be impossible to implement, because it ignores the daily transaction clearing practices in use by most financial institutions. While the Proposal would require financial institutions to wait until the actual purchase amount is presented for payment before determining whether the purchase created an overdraft, [8] the reality is that after a pre-authorization is made, the financial institution loses its discretion to refuse payment and must place a hold on the pre-authorized funds, thereby ending the institution's ability to apply those funds to other transactions. In fact, the Proposal recognizes the institution's inability to decline payment, but justifies the proposed regulation on the ground that "the card issuing financial institution is not required to send payment for an authorized transaction until the transaction is presented for settlement by the merchant and is posted to the consumer's account." [9] But the Agencies' justification ignores the reality that even though the funds may not actually be transferred from the consumer's account on the day of the pre-authorization, they are, from that day forward, unavailable to pay other debits on the account. For purposes of honoring a customer's drafts, there is no meaningful distinction between funds subject to a hold and funds that have been paid out from the account.

Without the ability to assess an overdraft service fee, the consumer's financial institution—fearful of potential losses due to non-payment—would likely decline to pay any subsequent draws on the account if such payments, evaluated in light of the pre-authorization amount, would *potentially* cause the account to be overdrawn when the merchant presents the actual purchase amount for payment. Thus, the proposed regulations on debit hold transactions would substantially reduce the customer convenience that debit cards provide, and might even discourage some banks from issuing debit cards.

In some situations, such as when a consumer books a multi-night hotel stay, the merchant may not present an actual payment amount until several days after the initial pre-authorization amount was requested. In the days between the initial pre-authorization request and the presentment of the actual payment amount, several credits and debits may appear on the consumer's account. In such situations, it would be difficult to determine whether the net result of such intervening transactions would have resulted in an overdraft. And even if the Agencies were to permit financial institutions to apply the payment amount retroactively by allowing them to "look back" at the account during the hold period and calculate whether overdrafts would have occurred if the actual purchase amount been paid on the date of pre-authorization,

[8] *Id.* at 28932 ("The proposed provision would not prohibit institutions from assessing an overdraft fee if the consumer's account has insufficient funds to cover the actual purchase amount *when the transaction is presented for settlement* (and the consumer has not opted out)." (italics added)).
[9] *Id.*

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595

financial institutions would incur substantial programming costs to develop the technological capabilities to carry out such an analysis. The Agencies inadvertently acknowledge this technological deficiency in the "exceptions" section of the Proposal by stating that "it would be infeasible for these institutions to determine at any given point in time whether the consumer in fact has a sufficient balance to cover the requested transaction."[10]

The Proposal recites the source of the Agencies' concerns about charging services fees for paying overdrafts caused by debit holds: "Agencies are concerned that consumers unfamiliar with debit hold practices may inadvertently incur considerable overdraft fees on the assumption that the available funds in their account will only be reduced by that actual purchase amount of the transactions." [11] We understand that consumers may be unaware of how debit holds function. But instead of the method proposed, we believe that the Agencies should adopt a more practical approach, perhaps by requiring financial institutions to provide customers with a basic explanation of how debit holds operate and why overdrafts caused by debit holds may result in the assessment of overdraft service fees. Such an approach would plug the "unfamiliarity" gap with consumers while allowing financial institutions to maintain their discretion to apply overdraft charges in situations where funds are unavailable.

Transaction Clearing Practices

Although it does not create any new rules governing transaction clearing practices, the Proposal does solicit comments on whether the Agencies should impose a requirement that would, absent consumer consent to the contrary, require financial institutions to pay smaller dollar items before paying larger dollar items when those items are received on the same day. The solicitation aims to address the perceived problem of financial institutions manipulating their posting methods to increase fee income. Because we understand the reasons for the Agencies' concern, we have spent the past decade counseling against intentional, calculated and harmful posting order manipulation. We are, however, equally concerned about any regulations that would require consumers to consent to a specific method of clearing transactions. In our opinion, such a requirement would ignore the reality of how transactions are actually posted while providing little or no benefit to consumers.

Transaction clearing methods vary widely and various dynamics influence what type of transaction posting order a financial institution will adopt. For example, some institutions post non-recourse cash disbursements, such as Teller and ATM withdrawals, before posting any other transactions. Other institutions post checks first, with some of those institutions ordering the checks by dollar amount and others ordering them sequentially by number. Instead of requiring the use of a specific type of transaction clearing practice, we believe that financial institutions will be deterred from manipulating posting orders if they disclose their posting order and method; as part of their deposit agreements and new account disclosures, and with advance notice if they subsequently change their posting order . For this reason Strunk has always advised its clients to disclose their transaction clearing methods to consumers and to give advance notice to consumers if they change posting methods.

[10] *Id.* at 28931.
[11] *Id.*

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595

Sam Davis
President
sdavis@strunklp.com

We simply do not see the benefit of requiring consumers to affirmatively consent, separately, to a specific type of account posting method. And given the numerous permutations of transaction clearing practices currently in use, the notion that a consumer would be able to discern the advantages and disadvantages of a particular method is, at best, optimistic. *Furthermore, imposing a regulation that has the practical effect of requiring that the lowest dollar amount transactions be posted first could actually harm consumers*. Again, we agree that manipulation of posting orders solely to increase fee revenue should be discouraged. However, as the Agencies are aware, *the items most consumers would want paid first*—mortgage, rent, car payments, credit card payments, utilities—*are usually their highest dollar transactions*. Imposing a lower-dollar-amount first approach may not only leave the most important items unpaid, it would subject the consumer to the payee' and the financial institution's insufficient funds fee and could damage the consumer's credit rating.

Conclusion

We agree with the Agencies that consumers should be able to opt out of any overdraft protection service that is not serving their needs. We further agree that the notices used to inform consumers of their right to opt out should carry a certain degree of uniformity. *However, we believe the benefits offered by other provisions in the Proposal, such as the partial opt-out provision, are outweighed by their costs*. Therefore, we request that the Agencies adopt the provisions of the proposed amendments that would create a substantive right to opt out of overdraft services, but *we also request that the Agencies take a much more practical "all-or-nothing" approach to any consumer opt-out right*.

If the board or any of the agencies would like clarification of any of our comments, or has any questions, or would like additional information, please do not hesitate to contact me directly. Thank you for your consideration of our comments.

Very Truly Yours,

MAIN OFFICE: 14614 Falling Creek Drive, Suite 110, Houston, Texas 77068-2942 ※ Office (800)728-3116 ※ Fax (281)440-1499
KANSAS CITY OFFICE: 202 NW Platte Valley Dr., Riverside, MO 64150 ※ Office (877) 485-8808 ※ Fax (816) 746-5595