Carl Howard
General Counsel
Bank Regulatory

Citigroup Inc.
425 Park Avenue
2nd Floor/Zone 2
New York, NY 10022

Tel 212.559.2938
Fax 212.793.4403
howardc@citigroup.com

By Electronic Delivery

August 8, 2008

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
Attention: OTS-2008-0004
1700 G Street, NW
Washington, DC 20552
http://regulations.gov (Federal eRulemaking Portal)

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
http://regulations.gov (Federal eRulemaking Portal)

Subject: Federal Reserve Board: Docket No. R-1314
Office of Thrift Supervision: OTS-2008-0004
National Credit Union Administration: RIN 3133-AD47
Unfair or Deceptive Trade Practices; Overdraft Services
Proposed Rule – Comments of Citigroup Inc.

Dear Sir or Madam:

This comment letter is submitted by Citigroup Inc. ("Citigroup"), on behalf of itself and its subsidiaries, in response to the joint proposal by the Federal Reserve Board (the "Board"), the

Office of Thrift Supervision and the National Credit Union Administration (collectively, the "Agencies"), to exercise their authority under Section 5(a) of the Federal Trade Commission Act to prohibit institutions from engaging in certain acts or practices in connection with overdraft services for deposit accounts (the "Proposal").[1]

This comment is organized in four parts. First, we briefly summarize the Proposal. Second, we explain our view that the Agencies should not address this matter through a rulemaking focused on "unfair" or "deceptive" trade practices. Third, we address the reasons that enactment of this regulation should be only prospective and have an implementation date no sooner than 18 months after final publication in the Federal Register. Finally, we comment on the specific details of the Proposal.

A. General: The Proposal.

The Proposal would require that banks[2] follow certain rules with respect to their overdraft practices, lest they be considered to be engaged in "unfair and deceptive" acts or practices. In summary, the Proposal would require a bank that charges fees for paying overdrafts:

- To provide consumers with notice and the right to opt-out of the bank's overdraft services. These must be provided before the bank's assessment of any fee, and again during any statement cycle in which a fee is assessed.

- To allow the consumer to elect a partial opt-out, where the bank may pay (and may charge for) overdrafts related to checks and ACH transfers, but not for ATM or debit card point-of-sale (POS) payments. The Agencies justify this requirement on the basis that "potential merchant fees and other adverse consequences" could flow from the nonpayment of checks and ACH transfers, and so the consumer should be allowed to avoid those consequences without having to pay overdraft fees associated with ATM and POS transactions.

Narrow exceptions to these general rules would allow a bank to pay, and charge for, an overdraft initiated by a debit card transaction, even if the consumer has opted-out, under the following circumstances:

- If there were sufficient funds in the consumer's account at the time the transaction was authorized, but the actual purchase amount exceeded the amount that had been authorized; or

[1] 73 Fed. Reg. 28904 (2008). Citigroup is filing a separate comment letter on the aspects of the Proposal that address certain acts or practices in connection with consumer credit cards accounts. In addition, on July 21, 2008, we filed a comment letter with the Board on Docket No. R-1315, the Board's related proposal to modify the Board's Regulation DD.

[2] Although the overdraft practices portion of the Proposal would cover other types of entities as well, we have confined our comments to banks under the authority of the Board.

- If the transaction were presented for payment by paper-based means, rather than electronically through a terminal, and the bank had not previously authorized the transaction.

As an example of the first exception, the Proposal describes a situation where a consumer uses his or her debit card to purchase gasoline. The merchant may seek a $1 authorization to ensure that the card is valid, and then submit the actual amount after the consumer has pumped the gas. An overdraft could result if the consumer purchased $50 in gas while only having $40 in his or her account.

The second exception is intended to address a situation where a merchant presents a debit card transaction for payment by paper-based means at end-of-day settlement, where the merchant did not obtain authorization at the time of transaction. This may occur if the merchant makes an imprint of the consumer's debit card at the time of the transaction and later submits the imprint and sales slip to its acquirer for payment.

The justification for these exceptions is that, in both examples, the bank was not given the opportunity to verify that the consumer had sufficient funds until after the transaction was completed. Finally, the Proposal states that a bank may not assess an overdraft fee if the consumer's overdraft would not have occurred but for a hold placed on funds in the consumer's account that is in excess of the actual transaction amount.

B. The Proposal Should Not Be Addressed through the FTC Act.

In summary, we believe that the Agencies are dealing with a *disclosure* issue, rather than an "unfair" or "deceptive" practice issue that is more appropriately addressed by enforcement of Regulation DD.[3] We agree with the requirement that a bank must inform its customers, before paying an overdraft, that there will be a charge for that overdraft, and the amount of the charge. This is a standard practice in the industry and required by Regulation DD.[4] However, the payment of an overdraft and the charging for that service should not be viewed as an intrinsically "unfair" or "deceptive" practice if the customer has been previously informed of the practice and the related charges. To the extent that the Agencies have concerns that institutions might pay and charge for overdrafts without adequately disclosing the fees to consumers, these concerns can be addressed through current enforcement mechanisms and, in the case of banks, through rulemaking, guidance and the examination process.

As a threshold matter, the Agencies have failed to meet the standards for declaring the overdraft practices addressed in the Proposal as either unfair or deceptive. The practices are not "deceptive" as they are fully and clearly disclosed to customers. As the Proposal describes, to be

[3] 12 CFR Sec. 230.1 et. seq.
[4] 12 CFR Sec. 203.4(b)(4)

"unfair," the Agencies must show: (1) substantial consumer injury; (2) injury that is not avoidable; and (3) the benefits do not outweigh the injury.

Regarding the first requirement, the practices addressed in the Proposal, namely charging overdrafts without providing a way to opt-out of overdraft charges and placing a hold on the basis of authorization by a merchant, involve the imposition of relatively modest charges on consumers. If the first test is to be meaningful, "substantial" injury should mean something more than the imposition of a relatively modest fee for the provision of a customer service when the possibility of the fee's imposition has been adequately disclosed. Regarding the second requirement, customers generally have the ability to avoid overdraft charges by monitoring the amount of available funds in their account. Finally, as discussed more fully below, the benefits of the current system where an opt-out is not required and banks can place credit holds based on merchant authorizations outweigh the modest injury that would theoretically be imposed on some customers if overdraft fees are imposed without changing these practices.

There are also important public policy reasons that favor our approach. We strongly believe that the practice of paying overdrafts results in a *favorable* outcome to the vast majority of customers, because, among other things, it enables them to complete their intended transactions in a timely fashion. Customers are responsible for managing their bank accounts. With today's technology, a customer can easily obtain information on their actual balances, whether via phone, ATM or internet. Knowing how much money is in his or her account is the customer's responsibility. Overdrafts are typically the result of a customer's failure to accurately calculate his or her balance and other outstanding items. When the bank pays the overdraft, it is presumably assisting the customer in completing the customer's intended transactions despite this mistake. In addition, excepting ATM and certain point-of-sale transactions, paying for an overdraft typically results in less expense to the consumer than having an item returned for insufficient funds, because in the latter case *both* the bank *and* the merchant usually charge NSF[5] fees to the customer.

Treating this issue as an unfair or deceptive trade practice will expose institutions to greatly enhanced litigation risk under both state and federal law. Additionally, the classification of these charges as unfair and deceptive in specific situations could be used against banks in lawsuits arising from activity that has already occurred.

C. <u>The Proposal must have prospective effect only and an implementation period of at least 18 months</u>.

Assuming arguendo that the Agencies move forward with this rulemaking, it is imperative that the Agencies give prospective effect only to any final rules resulting from the Proposal to limit (although, in our view, not eliminate) the litigation and reputational risks that are likely to flow from the re-characterization of heretofore lawful practices as unfair or deceptive. It is also

[5] "NSF" fees are fees for returned items.

imperative that the Agencies provide an implementation period of at least 18 months for such rules. Banks will require an implementation period of at least that length to make the extensive systems and operational changes likely to be required by the rules.

On the issue of prospective effect, the Agencies should take an approach similar to the one the Board followed in its recently announced final rule on advertising and disclosure practices for higher-priced mortgages. In that rule, which centered on unfair practices but used reasoning equally applicable to deceptive practices, the Board noted that a regulation is by its nature "prospective and applies to the market as a whole, drawing bright lines that distinguish broad categories of conduct." Docket No. R-1305 – Regulation Z, at 4 (July 14, 2008).[6] The Board then explained that its decision to proceed with such a regulation is based on a number of factors, including the "integral" factor of the Board's power to choreograph an orderly implementation of the regulation through a prospective enforcement rule and an appropriate implementation period.[7] The Board then provided unambiguously that "acts or practices occurring before the effective dates of these rules will be judged by the totality of the circumstances under other applicable laws or regulations."[8] We believe that such an approach is equally appropriate and necessary for the Agencies' proposed amendments, even though we remain concerned that it may not be enough to preclude vexatious and costly litigation under state UDAP statutes and otherwise based on the re-characterization of formerly lawful practices as unfair or deceptive.

On the issue of the implementation period, we believe that banks would require at least 18 months to develop and deploy the systems and operational changes necessary to implement any final rules resulting from this rulemaking including significant changes to printed materials and Internet sites, operational procedures, employee training, and a host of other business processes.

We urge the Agencies to approach the implementation period for any final rules resulting from the Proposal in much the same way the Board approached the implementation of the recently issued rule on higher-priced mortgages. There the Board recognized the difficult implementation challenges facing the industry by providing a baseline implementation period of approximately 14 months, with longer implementation periods of approximately 20 and 26 months respectively for parts of the rule presenting greater implementation challenges. We urge the Agencies to do the same here using a baseline implementation period of at least 18 months.

D. Specific Comments.

Although, as discussed above, we believe that this rulemaking is unnecessary as it concerns overdrafts, in this section we provide specific comments in case the Agencies decide to move forward with the Proposal.

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[6] 73 Fed. Reg. 44522, 44523 (2008).
[7] Id.
[8] Id.

1. Notice and opt-out. Banks cannot assess overdraft fees unless they first provide the consumer with notice and right to opt-out.

We agree that fees should be disclosed at account opening pursuant to Reg DD,[9] or pursuant to a change in terms notice if they are modified during the term of the account.[10] However, for the reasons discussed above, provided the customer has been previously informed of the practice and the related charges, we do not believe these practices should be considered as "unfair" or "deceptive."

Similarly, although we favor allowing banks that offer overdraft services the option to give their customers a right to opt-out, we do not believe that banks should be required to do so. If there is customer demand for the right to opt-out, some institutions will offer it, and customers for whom that is important can open accounts there. However, it should not be deemed an unfair or deceptive practice not to offer customers that choice.

Providing an opt-out right is also likely to be expensive for institutions to establish initially and to manage on a going forward basis. As the OCC Chief Counsel has testified before Congress:

Imposition of unnecessary regulatory burdens is not simply an issue of bank costs. When unnecessary regulatory burdens drive up the cost of doing business for banks, bank **customers** feel the impact in the form of higher prices and, in some cases, diminished product choice.[11]

If, despite our arguments, the Agencies decide to require banks to offer an opt-out right, then we recommend that the opt-out right requirement only extend to overdrafts at ATMs and debit card point-of-sale locations.

2. Bifurcated opt-out. The consumer must be given the choice to opt-out for all transactions, or *only* for payment of overdrafts at ATMs and debit card point-of-sale transactions.

If a bank gives their customers a right to opt out of overdraft services, the bank should have the option whether or not to give the customer the choice to opt-out for all transactions, or *only* for payment of overdrafts at ATMs and debit card point-of-sale transactions. Even if there is a consumer benefit in allowing the customer to choose that only certain overdrafts should be paid, the consumer benefits are not large and, because repeated overdrafts are incurred by only a small percentage of customers, affect relatively few customers. Furthermore, monitoring overdrafts in

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[9] This disclosure is already required in account-opening documentation. See 12 CFR Sec. 230.4(b)(4).
[10] 12 CFR Sec. 230.5.
[11] Statement of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, before the U.S. Senate Committee on Banking, Housing and Urban Affairs, on Regulatory Burden Relief, Washington, D.C., June 22, 2004 (emphasis in the original).

this manner puts an unfair onus on the bank. Finally, the practicality of bifurcating opt-outs will vary from institution to institution depending upon the construct of their systems and operations. In sum, this is another situation where the best solution is for the Agencies to leave the development of bifurcated opt outs to marketplace forces.

3. Additional appropriate circumstances for paying an overdraft where a customer opts out.

The Agencies requested comment on whether there are other circumstances in which an exception may be appropriate to allow an institution to impose a fee or charge for paying an overdraft even if the consumer has opted out of the institution's overdraft service, and if so, how to narrowly craft such an exception so as not to undermine protections provided by a consumer's opt out election. We strongly recommend an explicit exception for returned deposited checks or other items. There are instances where Reg. CC requires that funds attributable to deposited checks be made available to customers the day after the deposit although the bank has not yet received collected balances on account of those check deposits. Such deposited checks can be returned by the maker's bank for various reasons, including insufficient or unavailable funds or an unauthorized maker or endorser signature, and the available funds in the customer's account must then be reduced to account for the return. In the event that the reduction causes the account to become overdrawn, the bank should be entitled to charge the customer an overdraft fee whether or not the customer has exercised his or her right to opt-out of having overdrafts paid by the bank.

We also believe that banks should be specifically authorized to charge for overdrafts where there is express customer consent. It may be or become technologically feasible for banks to contact the customer by telephone, e-mail or text message, identifying a specific transaction that has been presented for payment, requesting and receiving instructions from the client on a case-by-case basis. We believe that banks should be expressly allowed to contact customers on such basis and charge them for such overdrafts, irrespective of whether they have opted out.

4. Periodic statement. Bank must provide another notice and opt-out "at least once" for any periodic statement cycle in which fee is charged.

We believe that the current industry practice that customers are notified of overdraft fees at account opening is sufficient and that it would be unduly burdensome on banks and confusing to customers to put additional disclosure on the periodic statements. This burden and confusion would be especially acute were the disclosure required to include an explanation about the customer's right, if any, to opt-out of overdraft service.

However, if the Agencies see a need to require banks to provide additional disclosure on any periodic statements, then we recommend that banks be permitted to provide an abbreviated form of notice on the periodic statements. Such a notice might read, for example, "You have been charged an overdraft fee, for information concerning the imposition of overdraft fees on this account, see your account manual or call customer service at 800-555-1234." During this call

the representative could also provide the total of the amount of overdraft fees charged to the customer's account to date. Not only would this information be more current, but it would alleviate the additional programming costs that banks would be required to incur in placing that information on each periodic statement. Further discussion about disclosures is in our July 21, 2008 comment letter to the Proposal to modify Regulation DD.

5. Debit holds. A bank may not assess an overdraft fee if an overdraft would not have occurred but for a hold placed on funds that is in excess of actual transaction amounts.

The Proposal's recommended treatment of debit holds is not feasible because there is no practical way that a bank can know if a particular hold is excessive or not. Indeed, as the Agencies' second proposed exemption implicitly recognizes, there are many circumstances in which a hold does not match the settlement. Moreover, the bank could not know with any certainty when a merchant has completed the transaction or transactions related to a particular hold. This issue is particularly acute with respect to bank account overdrafts which are settled on a daily basis. Management of holds is more appropriately conducted, as is the current industry practice, between the consumer and the merchant in connection with the merchant transaction.

6. Regulation AA. The Agencies should not extend the Credit Practice rule allowance for state exemption to the Proposal.

We agree with the Agencies' position as expressed in the Proposal that the Credit Practice rule allowance for state exemption should not be extended to the Proposal because it would undermine uniform application of federal standards, would not provide meaningful relief from regulatory burden and would not help consumers.

We appreciate this 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 or Jeffrey Watiker at (212) 559-1864.

Sincerely,

Carl V. Howard
General Counsel – Bank Regulatory

cc: Joyce Elkhateeb
Jeffrey Watiker
Viola Spain