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August 4, 2008

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

Regulation Comments, Chief Counsel's Office
Office of Thrift Supervision
Attention: OTS-2008-0004
1700 G Street, N.W.
Washington, DC 20552

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
regcomments@ncua.gov

Re: Overdraft Services; Regulation AA - Docket No. R-1314

Dear Sirs and Madams:

The California Bankers Association ("CBA") appreciates this opportunity to provide comments on behalf of itself and its FDIC-insured depository financial institution members in the state of California. CBA is a non-profit corporation established in 1891 and frequently provides comments on regulatory proposals by the federal banking agencies that significantly affect the business of banking. CBA had earlier submitted comments on the proposal to amend Regulation DD related to overdraft services, and some of those comments are relevant here. This letter addresses the proposal ("Proposal") by the Federal Reserve Board, Office of Thrift Supervision, and the National Credit Union Administration ("Agencies") to amend Regulation AA to regulate overdraft fee practices.

UDAP

CBA is troubled with the categorical determination of the Proposal that charging an overdraft fee without first providing a consumer with an opportunity to opt out is an

unfair and deceptive act or practice. The only relevant prior regulatory concerns were expressed in interagency guidance on overdraft fees, which recommended that banks provide consumers with an opportunity to opt out of “bounce protection” programs if they are promoted. The Agencies have not articulated why the existing guidance requiring opt out of these programs is insufficient as to support creating additional UDAP liability. Also, the Proposal is much broader in that it encompasses traditional, discretionary overdraft procedures that are not promoted or advertised. Since the Agencies have articulated no concerns about these practices, we question how those practices can be the legal basis of UDAP liability. Instead, any concerns should be addressed exclusively through proposed rulemaking under other regulations such as Regulation DD and Regulation E, and through less formal guidance.

None of the elements of the FTC standard for UDAP is met with respect either to promoted or non-promoted overdraft operations. First, fees for overdraft services are not injurious when properly disclosed. The Agencies have merely asserted that the fee is unfair without offering evidence. Second, overdraft fees are reasonably avoidable by the consumer, as consumers are in the best position to manage their own accounts. Indeed, many banks provide consumers with tools to avoid overdrafts, such as offering various means to check balances and providing ways to link accounts with credit card and other accounts. Finally overdraft services provide countervailing benefits to consumers that outweigh the costs in fees. This last point is disappointingly ignored in the Proposal, which fails to acknowledge the benefits of overdraft coverage to the consumer and fails to weigh them against avoided costs as discussed below. The Proposal simply and narrowly posits that overdraft fees are detrimental to consumer and not offset by any benefits at all.

It is our understanding that most bank customers typically do not overdraw their accounts. If this is true, then most consumers would not benefit from an opportunity to opt out and, as we explain further below, they may indeed be confused by the option. Therefore, we reject this approach to describe discretionary overdraft practices as unfair and deceptive when the opportunity to opt out is not provided.

CBA is also very concerned about the litigation risks on financial institutions posed by the Proposal. Despite that the Proposal is intended only to have prospective effect, in California, we have little doubt that plaintiffs groups are eager to present the argument to the courts that a practice that is currently unfair and deceptive was also unfair and deceptive in the past. The Proposal puts banks at increased risks of meritless class action suits for past practices. CBA believes it is inappropriate for the Agencies to subject financial institutions to this new litigation risk without first providing substantial and significant evidence in support of such a change.

Consumer Confusion

As we noted in our previous letter on Regulation DD, allowing consumers to opt-out of discretionary overdrafts would create confusion among customers of banks that do

not promote their overdraft “services.” Customers who do not overdraw their accounts would be asked whether to opt out of a service they do not use or may not be previously aware of. If they elect not to opt out, they may be led to assume erroneously that their future overdrafts would be systematically covered. This misunderstanding could lead to confusion and unmet expectations, and perhaps even subject an institution to liability.

We also noted that consumers may not appreciate that, even if they opted out, they would still be charged for returned items (often the same fee) and that they may incur more fees in the form of payee bad check charges, and also be subject to penalties related to nonpayment of the underlying obligation, such as late rent fees. Failure to make such payments may also result in a negative credit rating for the consumer and other adverse consequences, such as termination of services.

The Proposal fundamentally does not account for these risks and assumes that, because a fee is charged for paying an overdraft, this result must be detrimental to the consumer. Indeed, the Regulation DD proposal floated a notice that suggests to the consumer that there are less costly alternatives to overdraft fees, but ignores these very relevant factors. Consumer confusion and ire would be compounded in light of the common situation in which funds are insufficient at the time of authorization but available at the time of settlement, usually because the consumer had or intended to deposit funds in advance of settlement. If a customer opts out, then the initial transaction would be systematically denied by the institution and produce a charge.

Opt Out/Debit Hold

The Agencies distinguish between ATM and point of sale transactions, and “all others,” and this distinction forms the basis for a requirement for institutions to provide consumers with the option of opting out only of overdrafts with respect to the former transactions. The partial opt provision of the Proposal raises unwarranted expectations on the part of customers, and operational problems for institutions. POS debit card transactions are not clearly defined and consumers may be confused about the scope of their opt-out preferences. Debit cards are increasingly used for automatic bill payments and online purchases. Thus, consumers would not be clear about what they are opting out of.

The Proposal assumes that a bank’s discretionary overdraft system is a simple product that it could easily add or subtract from an account. The automated processing of discretionary overdraft decisions, however, is integrally tied into the core of each bank’s payments processing system. It would be extremely difficult to reprogram banks’ multi-faceted systems in order to comply with opt out requests, and to avoid paying certain overdrawing items.

Banks generally do not have the ability to set different limits solely on debit card transactions, as opposed to aggregate per-customer limits. And since the overdraft services are discretionary to begin with, institutions should not even be required to

provide overdraft services for any payment categories. Consumers who exercise a partial opt out may have unwarranted assurances of the payment of overdrawing checks. And institutions are sometimes not in a position (because of network rules for example) to decide that a POS transaction should not be paid.

The Agencies' position is particularly inappropriate in the many situations where an overdraft cannot reasonably or systematically be avoided by the financial institution. For example, many overdrafts occur because a POS transaction is authorized, but subsequently at settlement there are insufficient funds because in the interim the consumer initiated additional transactions. During the debit hold period, the institution must make timely decisions on whether to pay or return intervening items at the time that they are presented. Under the Proposal, the institution would have to recalculate every intervening transaction, and if the account appeared to be overdrawn, it would have to wait until settlement (because that amount is unknown to the institution) in order to determine whether it can impose a fee. Some merchants don't submit paper receipts for up to 30 days. How could the institution be deemed to act unfairly if it authorized a transaction when funds were available, but then charged a fee if it turns out that funds are not available?

The customer does know the final settlement amount, and if there are insufficient funds in the account, the customer can make a subsequent deposit or transfer to cover the transaction. The Agencies are correct in that the customer may not be aware of the actual amount of the merchant's hold (determined solely by the merchant), but this particular risk to the customer is outweighed by the risks imposed upon banks by paying overdrawing items without compensation. Moreover, many financial institutions, because they are aware of the practices of certain merchants like restaurants, hotels, and gas stations, do not place holds on authorizations. For these reasons, we request that the Agencies not to implement the prohibition related to excess debit holds

The proposed fee exceptions to opt out are not workable, that is: (i) where the debit card settlement amount exceeds the merchant pre-authorized amount; and (ii) where the debit card transaction is presented as a paper-based item and the bank had not previously authorized the transaction. As discussed, the exceptions assume that banks can systematically compare revisiting fees days after original assessment based on differences between hold amount and settlement amount. There is also no clear fee exception offered in cases where a customer made a deposit that is subsequently returned unpaid and charged back against insufficient funds; or for late settling debit card transactions which come in for settlement after the 3 day hold has dropped. To avoid risks, banks will be inclined to err on the side of returning more check and ACH transactions pending authorized debit card transactions.

Opt-Out Exercise

The proposal requires that the financial institution provide the consumer with the right to opt-out and a "reasonable period to exercise that opt-out." We request

clarification on what is a “reasonable period” for opt-out before a transaction can be paid in overdraft. We suggest that new customers have a period no more than 30 days in which to communicate their opt-out preference. If the customer has not expressed their preference within that timeframe, the transactions can be paid into overdraft. The proposal also provides that institutions must comply with a consumer’s opt-out request “as soon as reasonably practicable” after the institution receives it. We request that the Agencies allow an institution to determine what is a reasonable period to effectuate a request.

Unintended Consequences

When a customer opts out, the institution is forced to return overdrawn items unpaid. This would result in the payee’s account at another institution not receiving expected funds, which increases the likelihood that the other account would be overdrawn. As more items are returned rather than paid, there would be a cascading effect on the payment system in that all institutions would have an incentive to ensure that deposited items have cleared before giving consumers access to deposited items. These consequences would fall disproportionately on consumers who have opted out as institutions seek to protect themselves and the consumer. The net result is that deposits processing will be slower and less efficient, and more items would be returned unpaid.

Check Order Processing

We oppose any requirement for institutions to pay smaller dollar items received on the same day for purposes of assessing overdraft fees. There is no way for the institution to know the particular circumstances of the customer in order to assess which order of processing would benefit the customer most. The unpaid rent check may have a more deleterious impact on the customer than multiple overdraft fees. Moreover, the sheer volume of items that banks are required to process and the legal timeframes that must be followed make it very difficult for any institution to alter processing order for specific customers in order to minimize the assessment of fees. Similarly, we recommend no rulemaking with regard to regulating posting order.

State Exemptions

CBA strongly urges the Agencies not to permit states to seek exemption from the proposed rule, if adopted. Compliance with inconsistent state laws would impose an undue burden on institutions that operate in more than one state. For very good reasons, banks rely on data processing systems and programs that carry out operations uniformly throughout the enterprise.

Effective Date

In light of the myriad of rules recently issued that directly affect banks, including the rules on credit cards under Regulation Z, the proposed Regulation DD rules on

overdraft fees, and various regulations recently issued under the FACT Act, CBA strongly recommends an effective date of not less than two years following issuance, if the Proposal is adopted. We also recommend that the Agencies make clear that the rules apply prospectively only.

We appreciate this opportunity to provide these comments to the Proposal. We do not support creating UDAP liability as proposed because the elements for such liability are not established. We urge the Agencies to consider the more comprehensive costs and risks to consumers if more items are returned unpaid as a result of the Proposal, and the operational difficulties created by the requirement to offer an opt out opportunity. If you have any questions, please do not hesitate to contact the undersigned.

Sincerely,

A handwritten signature in black ink, appearing to read 'Leland Chan', is centered on the page.

Leland Chan
General Counsel