July 31, 2008

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

Chief Counsel's Office
Office of Thrift Supervision
1700 G. Street, NW
Washington, D.C 20552
Attn: OTS-2008-0004

RE: Proposed Amendments to Regulation AA
Docket No. R-1314
Docket ID OTS-2008-0004

Dear Ms. Johnson and OTS Chief Counsel:

On behalf of the 91 members of the South Dakota Bankers Association (SDBA), I offer the following comments on some of the rules proposed by the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision relating to Unfair or Deceptive Acts or Practices and Truth in Lending as published in the Federal Register dated May 19, 2008. The SDBA counts among its members more than 95% of the banks chartered and doing business within the borders of South Dakota. My comments relate to the proposed rules governing credit card industry practices.

The banking industry in South Dakota is generally supportive of many of the proposed rules relating both to the Board's Regulation AA (Unfair or Deceptive Acts) and Regulation Z (Truth in Lending). For example, SDBA member banks generally support regulatory changes which would prohibit double-cycle billing and the use of universal default as a reason for re-pricing pre-existing cardholder debt. However, some SDBA members in the credit card business strongly oppose some of your proposals which move away from allowing the forces of supply and demand to determine the price of unsecured, revolving credit and instead, move toward regulatory caps on rates or fees and further defining any amount in excess of that maximum to be "unfair" as a matter of law. The members of the SDBA feel the expansion of the role of banking regulators demonstrated in this proposal is not in the best interests of banks or their customers.

No doubt, you will hear directly from credit card issuing banks about any technical or operational concerns they have with any of the particular regulatory changes being proposed. I will not attempt to reiterate or restate their specific concerns in my comments. Instead, I will focus on the broad, long-range impacts which some of your proposed changes will have on the credit card industry's business model as well as resulting impacts on current and prospective cardholders.

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In the new language of Section 227.27, you prohibit institutions from charging to a consumer credit card account security deposits and fees for the issuance during the 12 months after the account is opened that, in the aggregate, constitute the majority of the credit limit for that account. In the case of most credit cards, issuers don't charge upfront fees, particularly not at levels approaching half the amount of the available credit line. Banks issuing cards to prime borrowers don't need that level of up-front income because risk of default relative to available credit doesn't dictate payment of such an up-front fee. But the business model which has been developed over an extended period of time by card issuers in the sub-prime market segment dictates that a relatively high entrance fee is prudent and necessary from the standpoint of the bank's safety and soundness. Relatively low credit limits (e.g. $250) combined with origination fees, security fees and administrative fees exceeding 50% of that low credit limit have become the sub-prime industry norm for good reason.

The risk profile of the sub-prime card holder is much different from that of the prime borrower. Consumers whose credit scores are in the lower ranges don't regularly qualify for the kinds of rates and terms commonly associated with prime borrowers. There are a host of reasons why this group of consumers may fall into this sub-prime category, such as personal bankruptcy or checkered bill payment track records due to illness, divorce or general economic downturns which caused them to be unemployed for some period of time. But in today's consumer-driven economy, those higher-risk consumers still need access to a credit card for many basic everyday necessities that may be taken for granted by others who have access. It is very difficult, if not impossible to rent a motel room, rent a car, book an airline flight or in some cases, to execute a simple, small retail transaction without access to a credit card. It is undisputed that most of the growth of internet-based commerce is due to and largely dependent upon credit cards as the primary source of payment for goods and services.

Members of Congress and bank regulators alike have long encouraged banks to serve the underserved segments of American society, to find ways to bank the unbanked. Not long ago, the Chairman of the Federal Deposit Insurance Corporation asked for the cooperation and support of a group of depository institutions in the search for an alternative to payday lending. That experiment is currently underway.

In the specific case of credit cards, many large card issuing institutions determined that their business model didn't work well outside the prime borrower credit card market. Over the course of time, a number of smaller banks decided to do the hard work necessary to fill that void in the unsecured credit card market. A significant number of those smaller institutions are based in South Dakota.
Citibank's decision to move its credit card operations from New York to South Dakota in the early 1980s was driven largely by the fact that the legal and regulatory environment in New York at that time was causing their credit card business to be unprofitable. They moved to South Dakota because it provided an environment that allowed them to become profitable again. I respectfully submit that some of the proposed changes to restrict the ability of the market to determine the price of unsecured revolving credit will make some segments of this market unprofitable or will present inordinate risks to banks. In this instance however, card issuers won't be able to move to another jurisdiction in search of a legal climate where they can be profitable.

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The new pricing ceilings will become the law of the land. Card issuers facing the prospect of losing money will not stay in business. Current card holders will only have access to their existing cards under current terms until their contract expires. Card holders who have been unable to rehabilitate their payment history to a point where they can qualify for something other than a sub-prime card will find themselves without a source of unsecured, revolving credit. Through no fault of their own, these consumers will go from having access to a credit card with all its inherent benefits to having nothing at all. Who will advise this group of consumers why that is the case?

As you point out in your proposed rules, one of the key elements of determining whether or not an act is "unfair" under UDAP is judging whether or not a particular action on the part of a lender leads to the incurrence of a substantial injury not reasonably avoidable by the consumers themselves. I find considerable irony in the fact that action taken by a bank regulator out of a paternalistic concern over fees it deems to be too high could actually create a different unavoidable injury to a group of consumers, taking away consumer's rights to make their own choice among products offered by competing regulated lenders, and instead driving those in need of credit to unregulated providers.

Management personnel of numerous sub-prime credit card issuers are experienced in many aspects of the credit card business. Their skills in critical areas of risk management and card operations are considerable. They understand the intricacies of the credit card banking model and have applied their knowledge toward the development of a credit card banking model geared toward serving the needs of a group of people who at one time had no access to any forms of unsecured credit. These managers advise that some of your proposed changes will inflict severe damage to their risk-based pricing model, effectively making their card operations unprofitable. I take their comments at face value. I would strongly urge you to give serious consideration to the comments they submit in response to your proposed regulatory changes. Failure to do so will result in the curtailment of revolving unsecured credit to a significant number of current and prospective card holders who have no other source for this type of credit.

I recognize that consumers have submitted numerous comments in support of these proposed regulations. Sometimes when a consumer believes that a government regulator may be able to help them individually get a better deal on some product or service, then the individual tends to support the regulator's efforts. It is unrealistic to expect those individuals to be able to understand the cumulative, long-term effects of proposed changes which in the short-run may appear to be to their benefit. It is my hope that you, the regulator, will carefully consider those important differences as you deliberate the final form of these regulations.

Sincerely,

Curtis A. Everson
SDBA President

CE/th

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At the outset, I feel it is important to point out that depository institutions offer demand deposit accounts to their customers with the understanding that individual account holders will not knowingly overdraw their accounts whether by means of a written check, debit card purchase, cash withdrawal at an ATM or by any other means. However, bankers also realize that some customers may occasionally make mistakes and inadvertently initiate transactions which create a draw on the account which exceeds the available fund balance. As you point out, banks have historically used their discretion to determine whether or not to pay a particular overdraft. Due to the discretionary nature of that decision, institutions were not able to, nor were they required to "inform consumers about the existence of the service or otherwise promote the use of the service".

To the extent that some banks have "formalized" overdraft services programs, offering them to a certain segment of their depositors, you have proposed new rules which would prescribe certain practices or requirements relating to marketing, disclosure and implementation of those programs and which would prohibit certain acts or practices as "unfair" under the provisions of the Unfair and Deceptive Acts and Practices (UDAP) laws. While the members of the SDBA support workable regulations designed to assure transparency in disclosures of banking services and related fees, including overdraft charges and non-sufficient fund fees, banks have expressed concerns over their ability to comply with certain regulations, particularly those where individual examiners may have considerable discretion to draw the line between fair and unfair practices.

Standard of "Reasonableness"

You propose to define as an unfair act or practice, an institution's decision to assess a fee or charge on a consumer's account for paying an overdraft unless:

1. the institution has provided its customer the right to opt out of said service,
2. the institution provides a "reasonable" opportunity to exercise the opt out, and
3. the consumer decides not to opt out.

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Your proposed rule will “create a new substantive right for consumers to opt out of an institution’s overdraft service to ensure that they have a meaningful opportunity to decline the service”. You appear to have concluded that offering a customer the chance to opt out of overdraft protection service, either at the time a demand deposit account is opened or at the time the overdraft service is added to the customer’s account, will not be sufficient to meet your newly proposed “reasonable” opt out standard. Instead, you indicate that a bank will be required to offer yet another chance to opt out at the time when an actual fee for service has been assessed.

Your new rules put banks in the position of having to repeatedly ask customers to second guess their decisions to participate in some type of fee-based overdraft protection program. Regardless of how frequently or infrequently a customer might overdraw their checking account, you insist that the bank must formally notify the customer of their right to opt-out of the service. Failure to do so will put a bank at risk of violating a subjective “reasonableness” standard and therefore a potential violation of UDAP laws accompanied by restitution orders and / or civil money penalties. Banks will find themselves in the unenviable position of having to choose between the lesser of several evils:

1. Annoying customers with repeated requests to confirm or decline participation in an overdraft coverage program.
2. Reducing service to customers by refusing payment on non-sufficient fund items, thereby increasing costs to customers through NSF fees and retailer-imposed check collection fees.
3. Subjecting the bank and its shareholders to reputation risk and financial penalties associated with failure to comply with an examiner-determined standard of reasonableness in disclosures.

Your notice of proposed rules includes data published in a recent GAO report regarding the pricing of overdraft and insufficient fund fees, pointing to the fact that the average cost of overdraft and insufficient funds fees has increased roughly 11 percent between 2000 and 2007 to just over $26 per item. The GAO also reported that large institutions charged between $4 and $5 more for overdraft and insufficient funds fees compared to smaller institutions. Some consumer advocates may suggest that those fees are too high. I believe it is important to note that overdraft and insufficient fund fees should be priced at a level which discourages consumers from overdrawing their account. In today’s world, consumers have many tools they can use to monitor available balances in order to avoid overdrawing their accounts: printed statements, online-banking services via computer or inquiry at an ATM to name a few. Overdraft fees or insufficient fund fees of $25 to $30 per item are still lower than collection fees charged at many retail locations. As a matter of law in South Dakota, retailers can and do assess a collection fee of up to $40 per item. I strongly believe that the vast majority of consumers are perfectly capable of understanding the fees associated with overdrawing their checking accounts. I further believe those consumers are also capable of understanding options which are available to avoid payment of those fees if they so choose; such as linking their checking account to a savings account, credit card or line of credit.

Partial Opt-Out of Rights for Certain Electronic Transactions

Your proposal carves out a partial opt-out right that would allow customers to elect participation only in overdraft protection for paper checks, excluding debit card transactions at the point-of-sale and ATM transactions. Your proposal appears to be premised on the fact that customer’s aren’t at risk for payment of check collection fees at retail when a debit card transaction is refused due to non-sufficient funds. It appears that you fail to recognize that customers do place significant value on avoiding inconvenience and embarrassment at the retail counter when a debit card transaction is refused.

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Further, I believe your proposed rules fail to account for the complexity of designing and developing software for electronic banking platforms which can discern the differences between multiple types of electronic debit transactions, some of which a customer might want to have included or excluded from overdraft service coverage. Costs associated with that type of software development will have to be recaptured from someone within bank's customer base. Significant confusion between banks and their customers is probably inevitable.

Special Standards and Procedures for Debit Card Holds

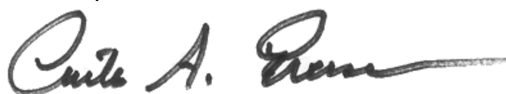
You also propose to prohibit certain acts or practices associated with assessing overdraft fees in connection with debit holds. It is important to understand that the bank with a checking account customer has, in many cases, no control over a retailer's decision to impose a hold and, in turn, to release a hold associated with the retail customer. Banks have no practical way to discern what type of transactions are taking place at the retail level where a hold is initially placed, an actual retail sale transaction or multiple transactions occur, and at some later point in time, the hold is released.

Once a hold is placed on funds in a customer's checking account, the bank has no choice but to treat those funds as obligated and unavailable to cover other demands. Banks do not have the luxury of being able to wait until they can examine the actual purchase transaction and decide at that time, whether or not there are funds sufficient to cover the transaction. In addition to the timing problem, the bank has no assurance that the actual purchase transaction is the one associated with the original hold or whether it is a new transaction generated for some other purchase in that business.

Conclusion

I recognize that consumers have submitted numerous comments in support of these proposed regulations. Sometimes when a consumer believes that a government regulator may be able to help them individually get a better deal on some product or service, then the individual tends to support the regulator's efforts. It is unrealistic to expect those individuals to be able to understand the cumulative, long-term effects of proposed changes which, in the short-run may appear to be to their benefit. It is my hope that you, the regulator will carefully consider those important differences as you move toward final implementation of these regulations.

Sincerely,



Curtis A. Everson
SDBA President

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cc. Senator Tim Johnson
Senator John Thune
Representative Stephanie Herseth Sandlin