haberfeld associates
206 S. 13th Street • Suite 1500 • Lincoln, NE 68508
(402) 475-1191 • fax (402) 475-2660

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

Attn: OTS-2008-0004

Unfair or Deceptive Acts or Practices

Dear Chief Counsel, Office of Thrift Supervision:

Haberfeld Associates is a consulting and marketing firm. For 27 years our entire focus has been to help banks maximize their personal and business checking account openings and optimize their profitability on those accounts.

Many of our most innovative ideas that were considered radical in the early years of our company are now the norm. We were the first to recommend and promote free checking. We were also the first to recognize that overdraft income is a normal and acceptable source of income from checking accounts. As overdraft fee income has become increasingly important to our clients' profitability, we have increased our understanding of the dynamics of overdraft and have accumulated a wealth of anecdotal and statistical information on this topic. We have also gained significant insights into the dynamics that drive overdraft behavior. **We have never recommended promoting overdraft services to customers or advertising in a way that could be seen as encouraging customers to overdraft.**

We currently work with 135 financial institutions with more than 2,500 branches in all parts of the U.S. These companies have more than 4,000,000 personal checking accounts. Most of our clients provide us with regular data extracts and many of them include account-level overdraft occurrences. Our data, therefore, has extremely high statistical validity. Comparatively, most of what has appeared in the press in the past few years is very anecdotal and represents the extreme exception. They are normally isolated worst-case scenarios.

Consumer groups frequently use these anecdotes as support for more regulation. They also suggest that the typical user of overdraft services is either older or younger than average and has a lower income. The centerpiece of their position is that these customers are more susceptible to unfair practices and/or suffer more financial harm as a result of them. Indeed, the whole basis for the proposed changes is to protect consumers from these unfair practices. In this response we will:

1. Show that this picture of the average overdraft user and the frequent overdraft user is inaccurate.
2. Discuss how overdraft fees are avoidable and the tools available to customers to manage their accounts.
3. Outline possible unintended consequences of the proposed changes.
4. Outline some issues with dictating a certain posting sequence.

The typical overdraft customer

We will use five separate studies to more accurately portray the "typical" overdraft customer. Our studies tend to identify the percentage of customers with zero overdrafts in a year and the percentage of total customers who write the great majority of overdrafts, which is typically 5% of all customers. Although banks do not generally know the incomes of individual customers, they do know the average monthly deposits which we believe to be a close proxy for take-home pay.

The first study[1] was done in 2003 by a bank client with 72,601 personal accounts. The study found that 67% of their customers had zero overdrafts. Just over 4% of the accounts in this case had nearly 60% of the overdrafts. This 4% had monthly deposits that were nearly 5% higher than the overall average account and that were over 8% higher than the accounts with zero overdrafts. Those with zero overdrafts actually had deposits that were 3% lower than the average account.

[1] This study was done by the bank and used several buckets, with zero overdrafts being the first bucket and over 100 being the last. Therefore, we couldn't match exactly to the top 5% standard of the remaining studies.

The second study was conducted in early 2007 using data extracts of several banks with 917,324 total personal checking accounts included. This study found that 74% of customers have zero overdrafts in a year (the range was from 59% to 86%). It also found that 5% of customers account for 65% of all overdrafts (range was 56% to 74%). In previous years, several studies conducted by small clients had produced similar numbers.

The third study used data from a bank with more than 200,000 personal accounts in six states. This bank had 83% of its customers without an overdraft in 2006 and had 5% of its customers accounting for 68% of its overdrafts. Using demographic data that was appended later, the bank showed that its high overdraft customers (the top 5%) had household incomes that were virtually the same as its average customer.

The final two studies we will reference were done during the second quarter of 2008 and used data from two banks: Bank A has 66,193 personal checking accounts in two states and Bank B has 137,009 checking accounts. These companies combine to have more than 150 branch locations. There was only one difference in the way the data was provided. Bank A gave us NSF data that was year-to-date through April and Bank B gave us data as of June with NSF data from the past twelve months. Both companies have been aggressively marketing checking accounts (including a free account) for several years and both pay (honor) nearly 90% of NSF items presented.

In addition to overdraft data, these banks provided date of birth and deposit information in the data extracts. This allowed us to examine the assertion that the young and elderly with lower incomes were the typical "victims." Our findings show a very different picture:

- At both companies, nearly 70% of customers had zero overdrafts.
- The top 5% overdraft customers accounted for 66% of all overdrafts at both companies.
- Those in their prime earning years (Gen X and Baby Boomers) made up 64% of the top overdraft customers at both companies.
- Gen Y did contribute just less than 30% to the top overdraft group at Bank A and just over 30% at Bank B, but Seniors (aka Silent Generation) provided only 6% to this group at both banks. Seniors make up 26% of all customers at Bank A and 19% at Bank B.

- The median monthly deposits of the top overdraft group were 63% higher than the median income overall at Bank A and were 87% higher at Bank B.
- The median monthly deposits of the Gen Y customers in the top overdraft group were 82% higher than that of the Gen Y customers overall at Bank A and were 115% higher at Bank B.

The profile of the typical overdraft customer created by this data is quite different than that suggested by consumer groups. The vast majority of customers have no overdrafts each year and two-thirds of all overdrafts are produced by 5% of customers. These customers are not skewed to the elderly or the young and – as deposits in checking accounts tend to be a direct reflection of earnings – they actually have above average incomes.

Overdraft fees can be avoided

It cannot, and should not, be overlooked that overdraft fees are completely avoidable. As far as we know, all of our clients will help their customers learn the simple basics of managing their checking accounts. All of our clients also offer alternatives to overdraft, such as lines of credit or automatic transfers to their customers. These products are not for everyone, however. Many customers will not qualify for an unsecured line of credit. Others do not want to siphon off their savings with automatic transfers, knowing that they may not replace the money.

Additionally, for those customers that wish to manage their accounts beyond their check registers or monthly statements, the banking industry has introduced several free and convenient channels to access information and transfer funds, such as 24/7 telephone banking and online banking.

We illustrated in our first point that the picture painted of the "typical" overdraft customer is inaccurate. All of the evidence points to the conclusion that for those customers that account for the vast majority of overdrafts, this is a choice. They **choose** to pay these fees by choosing **not** to manage their checking accounts in the traditional way. We cannot say how many simply choose not to keep track of their spending and deposits using their check register versus those that make a reasoned decision to overdraw their accounts. We do know that the decision to overdraw at a bank that will reliably honor an overdraft can be logical.

It wasn't that long ago that those customers who overdrew were viewed by most banks as undesirable. Checking accounts also typically had some form of explicit charge – minimum balance requirements enforced by penalty fees, a flat monthly charge regardless of balance and/or activity fees. Basically, **all customers** paid **explicitly** for their checking accounts. In addition, even though banks tried to push these customers out, 50+% of checking fee income came from overdrafts. Today, most banks have a free account that will be chosen by nearly half of their new customers and the remainder will go into an account for which they will rarely need to pay a fee, as they will generally satisfy a requirement to avoid it. Meanwhile, in today's more accepting environment, 20-30% of customers will **choose** to pay overdraft fees. These customers seem to view **paid** overdrafts as a valuable service rather than as a penalty.

Unintended consequences

It is always important to think through and identify in advance any unintended consequences of a given action. We believe that there could be several of these from the proposed changes.

The first likely unintended consequence could be a return to paying regular service charges on checking accounts. In the previous section, we explained the fact that the relatively new dynamic of free checking and more tolerant views towards overdrafts have resulted in a significant decrease in regular service charges on checking accounts. It is not hard to imagine that this attempt to regulate customer choice could result in a large reduction in income for banks and that this would force them to reconsider their pricing. The result would be that current checking customers that choose not to write overdrafts will once again be faced with a regular service charge on their account. As in the past, virtually every consumer would pay explicitly to maintain a checking account.

The second unintended consequence is that we will see many more checks returned to merchants. For those that opt out of having their checks paid with a fee, the bank will now return those checks with a fee. So, the customer will not owe the bank the principal and the fee, but they will still owe the fee. Additionally, it is likely that they will be charged another fee by the merchant, landlord, etc. to whom the check was returned. These customers may then lose check writing privileges with the merchant and may even have this information passed on to credit reporting agencies.

Additionally, in the process of clearing up their “bad check” they will suffer lost time and embarrassment.

A third unintended consequence is that customers will have purchases at the point of sale declined. Nobody is happy about the phenomenon of the “$33 latte” that has received so much press. However, the negative consequences of declining purchases at the point of sale have not been given equal coverage. The rise of the debit card and the convenience it brings has been one of the most significant changes in retail banking over the past ten years. The customer actually may not even have a checkbook or sufficient cash on hand anymore. Consumers are then faced with putting the purchase on a credit card, which is the next most likely form of payment they will have available. This, as we all know, has its own negative consequences.

On both sides of this issue, there has been some research done about consumer preferences regarding overdraft fees at the point of sale. It seems to us that neither “side” has asked the real question, which is, “Would you rather pay a $30 fee or have your purchase declined in front of your neighbor, pastor, co-worker, etc.?” That is where the “rubber meets the road” on this issue. It sounds like a great idea to opt out of a $33 latte, but the actual implications of a ***general*** opt out are not so desirable.

Fourth, it seems as though the issue of technical feasibility has not been adequately addressed. Our clients are all community banks and the diversity in their systems capabilities is astonishing. We do not pretend to be technical data processing experts, but it seems clear that the burden this might place on community banks to implement the proposals needs to be given more thought.

Fifth, the issue of the debit holds is extremely complex and could have the unintended consequence of leaving consumers more confused than they are now. The proposed rules for when a bank can assess a fee and when they can’t seem fair, but the rules will be far from clear to consumers. This will almost certainly result in more frustration and uncertainty, which they will direct back at their bank. The issue of these holds certainly does need to be addressed, as it makes it hard for even those who are diligent about recordkeeping to be sure to avoid a fee. We should, however, wait to address it until we can propose changes that will be clearly understood by all.

Finally, there is a macro issue which we do not believe has been adequately addressed. Many large banks and investment banks find themselves with overvalued, high-risk assets. Banking involves risk and underwriting is not an exact science, but, generally, community banks have been immune from the subprime mortgage debacle. We believe that the reason relates to checking accounts and fee income. Banks that rely on low-cost deposits and reliable fee revenue are not compelled to reach for yield; banks that finance their assets with high-cost liabilities always seem to be the first institutions to fail in a declining business cycle.

Posting Sequence

Posting high to low has been a controversial practice for many years. Long before the formal overdraft “programs” had become ubiquitous this practice was being challenged by consumer groups. They claimed it was a ploy to maximize overdraft income. The banks argued that it was beneficial in many cases because consumers would want their largest and most important checks to be paid, such as mortgage payments, rent and car payments.

Today, most items are electronic and the posting sequence issue gets fuzzier. Regardless of which argument you believe, many of our community bank clients currently have limitations on their flexibility to dictate posting sequence, which would make compliance with the proposal difficult.

The suggestion to post low to high also has some potential fairness issues. If you believe the case that high to low is unfair to consumers, then it follows that low to high is unfair to financial institutions. If you believe the case that high to low makes it more likely that your house payment will get paid, then low to high makes it more likely for that payment to be returned. It seems that paying the items in the order the customer initiated them is least controversial, but again, may not be feasible for all banks.

If high to low is unfair, then so is low to high. The larger issue may be the ability of many banks to implement any particular standard.

Conclusions and Summary

The desire to protect those who need it is understandable. Some of the personal stories that have received press evoke a strong emotional response. To characterize these isolated extremes as the typical overdraft consumer, however, is wildly inaccurate. Our data shows that the vast majority of customers have zero or one overdraft each year. The bulk of overdrafts (65%) come from 5% of customers. These customers actually have **higher** incomes than the typical bank customer and those with zero overdrafts actually have lower incomes on average. Contrary to the assertion of the consumer groups, the elderly actually make up a very small percentage (6%) of the most frequent overdraft group and those Gen Y customers in the top 5% of all customers in terms of overdraft earn significantly more than their peers.

While we all know that it is possible to overdraw once in a great while because of an error or oversight, to overdraw regularly is a **choice.** Individuals can easily correct this by managing their account. We believe our client group is very representative of the industry and we know that our clients are all willing to help customers learn the basics of managing their accounts.

With the growth of electronic transactions, posting sequence is not as clear cut as it once was. There are also good arguments why either extreme, high to low or low to high, can be most fair or unfair. On top of that, the ability of many companies to implement one or the other is very questionable. Given all of this, it is not a good idea to dictate a posting sequence at this time, or perhaps ever.

Finally, the proposed regulatory changes could have several very negative unintended consequences:

1. Lower fee income as a result of reduced overdraft income by regulating this choice by consumers could result in a return to regular service charges on checking accounts, which would mean **everyone** would pay explicitly for their checking accounts.
2. More checks will be returned, which will have many negative consequences for consumers: merchant fees on top of the bank fees, loss of check writing privileges, lost time and embarrassment. Merchants will also have the burden of collecting more returned checks.
3. More electronic items will be declined, causing consumers extreme embarrassment and, as the rise of the debit card has resulted in fewer people carrying cash or checks, they may use credit cards more often as a method of payment. This has its own negatives.

4. The proposal may not be technically feasible at this time.
5. Consumers may be more confused than they already are by the proposed changes in debit holds. They will likely not easily know if a transaction is one that might be paid with a fee or not. This is an issue that needs more planning and study to be addressed properly.
6. Posting low to high could actually result in a large item, like the mortgage, rent or a car payment, not being paid. The customer may then be subject to late charges that could exceed the cost of the overdraft or have rates increased on credit card accounts.

None of us likes the idea of people getting into financial trouble as a result of fees. Painting a picture of this as a typical scenario, however, is simply not accurate. This remains a matter of personal choice – do I mange my account or not? The tools are readily available to help. Most bank customers that are surprised by a $33 latte – as a result of **their choice** not to keep track of their accounts or spending – **can choose** to change the way they manage their accounts going forward so as to avoid it.

The regulations proposed are simply not the answer and are likely to have downsides for consumers that outweigh the upside. We would urge you to not move forward with these proposals.

Thank you for considering our views.

Sincerely,

Ralph Haberfeld, Chairman
Haberfeld Associates