POWELL
GOLDSTEIN
FRAZER &
MURPHY LLP
ATTORNEYS AT LAW

ATLANTA ■ WASHINGTON
RESIDENT IN WASHINGTON OFFICE
DIRECT DIAL 202-624-7261
JREVEAL@PGFM.COM

August 2, 2004

Via Facsimile, Electronic Mail and U.S. Mail

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
550 17th Street, NW
Washington, D.C. 20429

Attention: Comments

Re: **Comment: Overdraft Protection Guidance**
69 Fed. Reg. 31858 (June 7, 2004)

Dear Sir or Madam:

Powell, Goldstein, Frazer & Murphy LLP is submitting this comment with respect to the proposed Interagency Guidance on Overdraft Protection Programs (the "Proposed Guidance") on behalf of United Community Banks ("UCB"). UCB is the third largest traditional bank holding company in Georgia, with assets of $4.5 billion. UCB is headquartered in Blairsville, Georgia and operates 78 banking offices throughout Georgia, North Carolina and Tennessee. UCB specializes in providing personalized community banking services to individuals and small to mid-sized businesses in its markets.

UCB appreciates the opportunity to comment on the Proposed Guidance issued by the member agencies of the Federal Financial Institutions Examination Council (the "Agencies"). UCB's comments are limited to a single issue. In particular, we believe that there are very important distinctions between discretionary overdraft programs, as described below, and the other types of overdraft programs contemplated in the Proposed Guidance, and that it is crucial to the banking industry that this distinction be maintained so that banks, savings associations and credit unions (collectively referred to herein as "banking institutions" or "institutions") can continue to offer discretionary overdraft programs.

For purposes of the following discussion, this comment uses the term "overdraft item" to refer to a check or other debit presented against a deposit account when the account is either overdrawn or where payment of the item would cause the account to be overdrawn. Overdraft items may be paid or returned unpaid by the banking institution. For discretionary overdraft programs, payment or not of the overdraft item is in the institution's discretion. For other programs, whether the institution pays the item may depend on whether the institution has a

contractual obligation to the owner of the account on which the item is drawn, and on the terms of any such contractual obligation.

I. Overview of the Issue Addressed in this Comment

In the past ten years or so, banking institutions have begun to offer more formal discretionary overdraft protection programs (referred to in this comment as "Formal Discretionary Programs"). UCB and other institutions have taken great care in structuring, promoting, and disclosing these programs to ensure that they would not involve credit, extensions of credit or other credit facilities for purposes of the federal Truth in Lending Act ("TILA") disclosure requirements or State lending or interest and usury laws. In doing so, the industry was guided by TILA and Regulation Z, Official Staff Commentary to Regulation Z, State law definitions of credit and interest, and an important body of case law.

While the Proposed Guidance seems initially to recognize the distinction between Formal Discretionary Programs and other types of overdraft protection program, this distinction is not maintained throughout the Proposed Guidance. In particular, the Proposed Guidance seems to contemplate that all overdraft programs, formal or otherwise, involve extensions of credit or are "short term credit facilities." While this credit characterization *might* be appropriate for non-discretionary overdraft programs (which we do not address in this comment), we believe that it is not appropriate or useful to characterize Formal Discretionary Programs as involving extensions of credit. We also believe such a characterization to be inconsistent with TILA and case law.

The Formal Discretionary Programs that this comment considers have the following characteristics in common:

A banking institution will, from time to time and in its sole discretion, pay an overdraft item presented against a customer's account. The bank charges a nonsufficient ("NSF") item fee whether or not the bank pays the overdraft item, and this NSF fee is the same in amount whether the institution pays or "bounces" the item. The bank imposes no other charges for paying the overdraft item. In particular, the institution does not charge any fee that varies as to amount based on the amount of the overdraft item or the length of time that the customer takes to reimburse the institution for the paid overdraft item.

The institution may or may not promote the program. In any case, the institution's deposit account agreement with the customer clearly discloses that the bank may, in its sole discretion, pay an overdraft item but that the institution has no obligation to pay any particular item even if the bank has done so in the past. To the extent the institution markets the program, marketing materials also fully disclose the discretionary nature of the program.

Some institutions may disclose a "discretionary overdraft amount," which reflects the maximum amount of overdraft items that the bank would allow to be outstanding and

unreimbursed by the customer at any time. If the institution does disclose this discretionary overdraft amount, the institution clearly reiterates the disclosure that the bank will pay overdraft items only in its discretion.

II. The Four Basic Types of Overdraft Protection

The Agencies seem to recognize in the Proposed Guidance that there are essentially four different types of overdraft protection offered by banking institutions. (These programs are described in general terms in the first two paragraphs of the "Introduction" portion of the Proposed Guidance, and are discussed below in the same order as presented in the Proposed Guidance. 69 Fed.Reg. at 31860.)

However, we believe that the Agencies may be blurring some very important distinctions among the options. The following adopts the Agencies' general descriptions of the four options, but attempts to clarify the differences among the options. In Parts III and IV of this comment we discuss why these differences are important and why we are asking the Agencies to adopt these distinctions in any final Guidance.

1. Written Overdraft Lines of Credit. Banking institutions have long offered overdraft lines of credit to customers. When offered to a natural person for personal, family or household purposes, the line of credit would be subject to Truth in Lending disclosure requirements. In any case, any interest charged on the account would be subject to State interest rate limitations and, in some cases, any nonsufficient funds ("NSF") fee could be subject to State limitations.

2. Informal Discretionary Programs. Perhaps the most traditional and historical version was the practice of many institutions of paying an overdraft item for a known customer on an occasional basis, purely in the institution's discretion. This was not so much of a "program" as a practice. This practice, which could be as old as banking itself, was not formerly promoted by the institution and might even by thought of as simple civility (referred to herein as "Informal Discretionary Programs").

3. Formal Discretionary Programs. In recent years, the Informal Discretionary Programs have become automated at many institutions. Among other things, the automation allowed the institution to establish more uniform standards and to minimize the need for (and expenses of) human intervention. However, under these programs the institution still pays overdraft items only in its discretion, has no obligation to a customer to pay any particular overdraft item, and the institution clearly discloses the discretionary nature of the program. The common characteristics of Formal Discretionary Programs are described more fully at the end of Part I, above.

As discussed below, the only meaningful differences between these Formal Discretionary Programs and the Informal Discretionary Programs described in paragraph 2, above, is that the

institution has automated the process and might promote the program in some manner. These Formal Discretionary Programs are the focus of this comment.

4. Informal Lines of Credit. After the Agencies discussed the above three options, the Agencies then discuss programs that are "marketed to consumers essentially as short-term credit facilities...." This "program" appears really to be only a Formal Discretionary Program where the institution became obligated to pay overdraft items, perhaps up to a specified "limit," either because the institution's deposit agreements or marketing materials effectively promise that the institution will pay overdrafts, but where the promise is not evidenced by a formal, written overdraft line of credit.

This comment refers to the options described in sections 2 and 3 above as "Discretionary Programs," distinguishing such programs from those described in sections 1 and 4 where the institution has a legal obligation to pay overdraft items under certain circumstances.

III. The Proposed Guidance Blurs the Important Distinctions between Discretionary Programs and Non-Discretionary Programs

It appears that one aim of the Proposed Guidance is to address the compliance issues and best practices of Formal Discretionary Programs. See 69 Fed. Reg. at 31,860 (noting that a major concern of the Agencies are overdraft protection programs which are "promoted in a manner that leads consumers to believe that overdrafts will always be paid when, in reality, the institution reserves the right not to pay some overdrafts"). In discussing their concern over the increasing use of Discretionary Programs, the Agencies note:

> some institutions have promoted this credit service in a manner that leads consumers to believe that it is a line of credit by informing consumers that their account includes an overdraft protection limit of a specified dollar amount without clearly disclosing the terms and conditions of the service including how fees impact overdraft protection dollar limits, and how the service differs from a line of credit.

69 Fed. Reg. at 31,860.

UCB can appreciate the concerns noted by the Agencies in the Proposed Guidance, and we appreciate the opportunity for formal regulatory guidance. We also support, in general, more precise disclosure of the terms of Discretionary Programs, particularly Formal Discretionary Programs.

Our concern is that, after the Agencies seem to acknowledge that institutions offer both Discretionary Programs and Non-Discretionary Programs, the Agencies seem to lose sight of this

distinction and repeatedly imply that all of the four program types involve extensions of credit. As discussed below, we believe that, with respect to Formal Discretionary Programs (1) it is inconsistent with TILA and case law to treat these programs as credit facilities; and (2) this characterization exposes institutions to significant risk of law suits under State lending and interest laws by implying that the Agencies fully consider the Formal Discretionary Programs (or the Informal Discretionary Programs, for that matter) as involving extensions of credit.

IV. Discretionary Programs Do Not Involve Extensions of Credit

A. Discretionary Programs Do Not Meet the Regulatory Definition of "Credit" Under the Federal Truth in Lending Act and Therefore Should Not Be Characterized as Credit in the Proposed Guidance

Contrary to the implications in the Proposed Guidance, Discretionary Programs do not involve extensions of credit for TILA or State law purposes and are not "short-term credit facilities" or a "credit services," as explained below.[1]

Regulation Z defines "credit" as "the right to defer payment of a debt or to incur a debt and defer its payment." 12 C.F.R. §§ 226.1(c) (discussing the coverage of Regulation Z) and 226.2(a)(14) (defining "credit"). Most deposit agreements used by depository institutions that offer Discretionary Programs state that the depositor is required to reimburse the depository institution immediately for any overdrafts paid by the depository institution. In those cases where the deposit agreements do include such terms, it follows that a depositor does not have the *right* to defer payment of a debt or to incur debt and defer its payment in connection with Discretionary Programs. That is, the Discretionary Program does not provide for an extension of credit under TILA.

Even if the Discretionary Programs are a type of "credit" for TILA purposes, in order for TILA to apply, four additional conditions must be met: (i) the credit is offered or extended to consumers; (ii) the offering or extension of credit is done regularly; (iii) the credit is subject to a finance charge or is payable by written agreement in more than four installments; *and* (iv) the credit is primarily for personal, family, or household purposes. 12 C.F.R. § 226.1(c). Assuming for this purpose that conditions (i), (ii) and (iv) are satisfied, Discretionary Programs still would not be subject to TILA because they involve neither finance charges nor written agreements for repayment in more than four installments, as discussed below.

---

[1] We recognize that the Agencies may not have the authority to determine whether Discretionary Overdraft Programs are credit products for State law purposes, and we recognize that some States may choose to enact legislation that causes such products to be treated as credit. Our aim in part is to dissuade the Agencies from treating Discretionary Programs extensions of credit for TILA purposes, or from otherwise characterizing or referring to Discretionary Overdraft Programs as credit products, so as to avoid any implication that such characterization or reference applies under State law.

TILA defines a finance charge as 'the cost of consumer credit as a dollar amount" which includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." 12 C.F.R. § 226.4(a). Notably, the TILA definition of a finance charge excludes "[c]harges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing." 12 C.F.R. § 226.4(c)(3) (emphasis added). The very nature of a Discretionary Program is that the depository institution may, but is not required to, pay overdraft items, and this is clearly disclosed in the Formal Discretionary Programs that are the subject of this comment. Because there is no agreement to pay each or any overdrawn instrument, the Discretionary Programs satisfy the exclusion noted above.

Section 226.4(b)(2) of Regulation Z and its associated Staff Commentary indicate that overdraft fees are finance charges when imposed "in connection with a credit feature," but then only to the extent the charges exceeds the charge for a similar account without a credit feature. See 12 C.F.R. § 226.4(b)(2) and Reg. Z Official Staff Comment at 4(b)(2)-1. Because Discretionary Overdraft programs do not involve "credit," as discussed above, NSF charges should not be considered to be finance charges. Moreover, as discussed in Part I, institutions offering Formal Discretionary Programs typically charge the same fee whether the institution pays or bounces the item. In those cases where the NSF fee is the same whether the overdraft item is paid or not, the NSF fee should not be considered to be a finance charge for TILA purposes.

In addition, under Discretionary Programs, most depository institutions charge an overdraft fee regardless of whether the depository institution honors the overdrawn instrument. In the case where a depository institution does not honor an overdrawn instrument yet charges an overdraft fee, there is no "extension of credit" and the overdraft fee cannot be viewed as a finance charge. If the institution does pay the item, it would charge the same NSF as it would have charged if it had not paid the item and, therefore, the NSF fee should not be considered to be a finance charge. Therefore, an overdraft fee obtained under a Discretionary Program is not a finance charge for TILA purposes, and since most Discretionary Program agreements do not contain any clauses that the overdrawn instrument can be repaid in four or more installments, TILA does not apply to Discretionary Programs.

B. Discretionary Programs Are Not "Credit" Under the Case Law Interpreting the Federal Truth In Lending Act and the National Bank Act and Thus Should Not Be Characterized as Credit In the Proposed Guidance

There is ample case law in a variety of jurisdictions concluding that a depository institution does not extend credit for TILA purposes when it pays overdrafts from time to time on a discretionary basis in the absence of a formal, written overdraft line of credit. Numerous federal and state courts have held that overdraft fees charged by depository institutions are not finance charges.

Federal courts in Mississippi have concluded that overdraft charges are not finance charges for TILA purposes. See, e.g., Nicolas v. Deposit Guaranty National Bank, 182 F.R.D. 226 (S.D. Miss. 1998) (where deposit agreement provided that bank could, in its discretion, pay or return checks presented against insufficient funds, and bank charged consumer a $20 fee per item regardless of whether the bank paid or returned the check); Terrell v. Hancock Bank, 7 F. Supp. 2d 812 (S.D. Miss. 1998).

In addition, both the Southern and Northern District Courts in Mississippi held, in separate cases, that a daily overdraft fee was not a finance charge for TILA purposes where the parties did not agree in writing that the bank would pay the overdrawn items. Taylor v. Union Planters Bank of Southern Mississippi, 964 F. Supp. 1120 (S.D. Miss. 1997); Sims v. Union Planters Bank of Northeast Mississippi, NA, 1997 WestLaw 170309 (N.D. Miss. 1997).

Similarly, numerous courts have held that overdraft and nonsufficient funds fees are not interest. In First Bank v. Tony's Tortilla Factory, Inc., 877 S.W.2d 285 (Tex. 1994), the bank had, from time to time, honored certain of the depositor's overdraft instruments. A nonsufficient funds fee was always charged to the depositor's account, whether or not the bank honored the overdrawn instrument. The depositor sued the bank alleging that the bank's nonsufficient funds fees were usurious. The Texas Supreme Court stated that fees which are "an additional charge supported by a distinctly separate and additional consideration, other than the simple lending of money, are not interest and thus do not violate the usury laws." 877 S.W.2d at 287. Because the court concluded that each nonsufficient funds fee was a separate and additional consideration for processing each bad check, the court concluded that the nonsufficient funds fees were not interest. Id. at 287-288. The Texas Supreme Court found that the consideration for the funds advanced to cover the bad checks was not the nonsufficient funds fee, but was the customer's promise to repay that advance. Id. at 288. The court also noted that "the mere profitability of the NSF fee to First Bank does not make the fee usurious interest." Id.

In Video Trax, Inc. v. NationsBank, N.A., 33 F. Supp. 2d 1041 (S.D. Fla. 1998), the United States District Court for the Southern District of Florida held that nonsufficient funds fees were not interest under either the National Bank Act or Florida law. In this case, the depository institution not only charged a flat overdraft fee for each overdraft instrument presented, but the depository institution also charged interest on those overdraft instruments. The plaintiffs did not challenge the interest charges on the overdrawn balance, but challenged only the overdraft fee on the grounds that the fee was also "interest." In this case, the bank had discretion as to whether to honor or dishonor any particular overdraft instrument; the bank was not obligated by any specific overdraft line of credit or other agreement to honor any overdrafts.

The plaintiff depositor argued that the definition of interest in the National Bank Act preempted the Florida law definition of interest. Although the court did not concede that the National Bank Act definition was controlling, the court went on to conclude that overdraft fees were not interest under the National Bank Act. Id. at 1049-1050. The court reached this conclusion

"because the OD fees were not imposed in connection with a credit transaction" but instead arose from the terms of the deposit agreement. Id. The court looked to "the ordinary meaning" of interest in reaching its conclusion under the National Bank Act, stating that interest "includes any compensation allowed by law or fixed by the parties for the use or forbearance of money." Id. at 1049. The court also recognized that the bank's overdraft fee reflected allocations of administrative costs consequent to the processing of checks -- i.e., that the overdraft fee was a processing fee, not interest. Id. at 1051.

In considering whether the overdraft fee was interest under Florida law, the court noted that Florida law specifically provided that "the calculation of unlawful rates of interest 'shall apply only to loans and advances of credit.'" Id. at 1052 (citing Fla. Stat. 687.03(2)(b)). The court concluded, however, that honoring checks on overdrawn accounts is not an extension of credit. Id.

A Federal court in Mississippi, considering Mississippi law and the National Bank Act, also concluded that overdraft fees were not interest. In Terrell, supra, the court held that nonsufficient funds fees were not interest under the National Bank Act because they are not imposed in connection with credit transactions, but instead arise under the deposit agreement. Id. at 816. With respect to Mississippi law, the court considered the Mississippi law definition of finance charge:

> [T]he amount or rate payable, directly or indirectly, by a debtor for receiving a loan or incident to or as a condition of the extension of credit, including, but not limited to, interest, ... service charges, transaction charges, ... or any other cost or expense to the debtor for the services rendered to the debtor in making, arranging or negotiating a loan of money or extension of credit....

Id. at 817 (quoting Miss. Code 75-17-25 (1991)). Based on this definition, the court concluded that the NSF fees were not interest because these fees were not charged in connection with credit. Id. The court also cited the Tony's Tortilla case as persuasive authority. Id. As in the other cases discussed in this section, the defendant bank in the Terrell decision honored overdrafts only in its discretion and was not obligated by written agreement to do so.

The regulations implementing TILA, case law and general industry practice for decades have illustrated that nonsufficient funds and overdraft fees are not ordinary interest charges or finance charges. Thus, for TILA purposes, the Discretionary Programs which are the subject of the Proposed Guidance are not and should not be referred to as "short-term credit facilities" or "credit services."

C. Formal Discretionary Programs are Indistinguishable from Informal Discretionary Programs for Legal Purposes

The cases discussed above arose prior to the wide spread use of Formal Discretionary Programs. However, Formal Overdraft Programs differ from the Informal Overdraft Programs that were the subject of these cases in only two ways: (1) Formal Overdraft Programs tend to be automated and (2) some institutions offering Formal Overdraft Programs establish overdraft thresholds either on an individual customer basis or with respect to all customers. We believe that these differences do not alter the fundamental conclusion that the discretionary overdraft programs do not involve extensions of credit for TILA or State law purposes.

The automation of Discretionary Programs simply reflects the times and the overall automation of banking So long as the institution retains discretion as to whether to honor or return an overdraft item, the program should not be considered to be a credit program simply because it is automated. When a bank elects for any reason not to pay an overdraft item for a particular customer, the bank simply changes a "switch" in the system so that the items would not be honored automatically.

Likewise, the possibility that some institutions might establish overdraft thresholds for Formal Discretionary Programs should not in itself convert the program into a credit product. The threshold is simply a risk control established by the institution -- an outside limit for the overdraft items that would clear the system automatically until such time as the institution flips the "switch" to stop payment of future items. This does not change the fundamental discretionary nature of the program and does not change the fact that customers have no rights to incur debt.

For these reasons, we respectfully submit that Formal Discretionary Programs should not be considered as involving extensions of credit for TILA or State law purposes, and that it would be inaccurate and inappropriate for the Agencies to publish final Overdraft Guidance that refers to such programs as "short-term credit facilities" or "credit services."

V. Conclusion

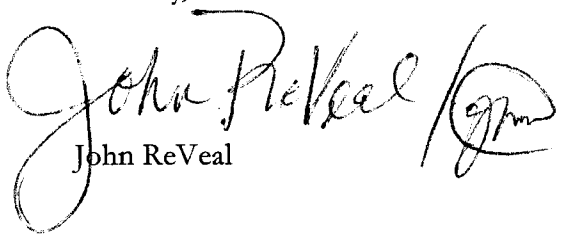
Depository institutions and consumers alike have suffered due to the lack of regulatory guidance for Discretionary Programs. UCB supports the Agencies' recommendation that regulatory guidance be enacted for Discretionary Programs. We believe that such guidance will assist financial institutions and can better protect consumers from confusing disclosures or inappropriate practices.

However, we strongly urge the Agencies not to characterize Formal Discretionary Programs as "short-term credit facilities" or "credit services" for the reasons discussed above. As discussed above, we believe that Formal Discretionary Programs do not qualify as, and should not be considered to be, credit services or short-term credit facilities. If any final Guidance issued by the Agencies characterizes Discretionary Programs as credit or credit facilities, that could mark the end

of Discretionary Programs, at least in the sense of the modern, automated programs that many depository institutions and vendors now offer.

UCB appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,



John ReVeal

cc: Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Attn: Docket No. OP-1198

Office of the Comptroller of the Currency
250 E. Street, S.W.
Public Information Room
Mailstop 1-5
Washington, D.C. 20219
Attn: OCC Docket No. 04-14

Regulation Comments
Chief Counsel's Office
Office of the Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attn: No. 2004-30

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

::ODMA\PCDOCS\WSH\329750\1