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

**RE: Comments on Interagency Guidance on Overdraft Protection Programs**

Dear Sir or Madam:

**OVERVIEW**

We thank you for the opportunity to comment on the proposed Interagency Guidance on Overdraft Protection Programs issued on May 28, 2004, by the five federal financial institution regulatory agencies, namely the Office of the Comptroller of the Currency ("OCC"), the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of Thrift Supervision ("OTS"), and the National Credit Union Administration ("NCUA"). Established in 1973, Profit Technologies Corporation ("PTC") is a leader in earnings enhancement advisory services for the banking and credit card industries. Since 1991, PTC has designed custom mainframe overdraft solutions for financial institutions. PTC's proprietary Courtesy Overdraft Processing System ("COPS℠"), which was created in 2001 as a response to "one limit fits all" overdraft protection programs, offers financial institutions a complete end-to-end overdraft solution that encompasses risk management, overdraft processing, collections, and recovery. PTC takes pride in the fact that its COPS℠ program has not been identified by consumer advocacy groups as being deceptive or misleading to consumers. In fact, of the 300 plus letters received by the FRB in early 2003 commenting on how bounce protection plans should be disclosed for truth-in-lending purposes, none of these letters related to or criticized the operation of PTC's COPS℠ program.[1]

A number of vendors offer "turnkey" programs and expertise enabling financial institutions to establish overdraft protection plans. While the systems adopted by the largest institutions have been developed internally, relying on their own empirical data and statistics, smaller community-based institutions tend to rely on systems developed by third-party vendors that may incorporate the standards, criteria, and customer- or item-specific attributes selected by the institution or developed by the vendor.

[1] On December 9, 2002, the FRB solicited comment regarding proposed revisions to the Regulation Z official staff commentary. [67 Federal Register 742618] Comments regarding the proposed revisions were due by January 27, 2003. More than 300 comments were filed in total, and no less than 278 of those comments related to the proposed disclosure of bounce protection programs under Regulation Z. Approximately two dozen of these letters were highly critical of the use of bounce protection plans by financial institutions. In an April 2003 rulemaking, the FRB declined at that time to take further action on the December 9, 2002 Regulation Z proposal.

While these systems may not be as empirically or statistically complex as those developed by larger financial institutions, vendor-"packaged" overdraft protection programs allow small institutions to automate a traditional practice, thereby reducing costs and ensuring more consistent application. Many smaller institutions use vendor-designed, "static" bounce protection plans that are not dynamic as to an individual customer's behavior, assigning instead an arbitrary bounce protection limit by product type. Overdraft protection plans "sold" to the community banking industry are also often actively and aggressively promoted to consumers. It is these types of "promoted" overdraft protection programs that are largely responsible for raising the ire of consumer advocacy groups, which in turn garners the attention of the federal financial institution regulatory agencies and Congress.[2]

PTC believes the agencies' proposed overdraft protection guidance reflects a regulatory reaction to the perceived abuses committed by flat line bounce protection vendors, *i.e.*, vendors with "promoted" bounce protection programs that set a fixed, arbitrary bounce protection limit assigned by product type. Indeed, a memorandum prepared for the Board of Governors by the FRB's Division of Consumer and Community Affairs, dated May 13, 2004, confirms this supervisory approach. We note that flat line bounce protection programs generally exhibit some, if not all, of the following characteristics:

(1) customers are led to believe that overdraft coverage can be relied upon, despite the fine print disclaimer that the institution is under no obligation to honor the overdraft and that payment of the NSF item is entirely discretionary on the institution's part;

(2) customers are advised what their individual "credit limits" are;

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[2] The National Consumer Law Center and Consumer Federation of America submitted lengthy comment letters responsive to the December 9, 2002 comment solicitation regarding possible revisions to the Regulation Z official staff commentary. These comment letters were highly critical of bounce protection plans that were aggressively marketed to consumers. The letters identified eight bounce protection vendors that marketed these types of programs - **Strunk & Associates, L.P.**, Houston, Texas, **John M. Floyd**, Houston, Texas, **BSG LLC**, Louisville, Kentucky, **Pinnacle Financial Strategies**, Houston, Texas, **Moebs Services**, **Alex Sheshunoff Management Services, L.P.**, Austin, Texas, **IFS Impact Financial Services**, Little Rock, Arkansas, and **Haberfield Associates**, Lincoln, Nebraska.

In a memorandum dated May 13, 2004 prepared by the FRB's Division of Consumer and Community Affairs for the Board of Governors of the Federal Reserve System incident to FRB adoption of the proposed amendments to Regulation DD, the memorandum notes on page 3 thereof that "Concerns about bounced-check protection services largely center on institutions' marketing efforts." That same memorandum on page 7 thereof reported commenters' observations regarding the operation of bounced-check protection services, in pertinent part, as follows:

> "Many of the commenters' concerns about bounced-check or overdraft protection programs focus on the marketing, which appears designed to increase the volume of overdrafts to generate additional fee income for the institution. Many marketing plans include materials written to encourage consumers to use the service as if it is a traditional line of credit, by stating that overdrafts up to a specified dollar limit will be paid. Notwithstanding this practice, qualifying language disclaims any legal obligations by the institution to pay any individual overdraft, but the disclaimer may not be prominent in the vendors' marketing materials."

(3) customers with repeated overdrafts or large overdrafts are encouraged to repay the overdraft amount owing over time, rather than immediately;

(4) no procedures exist to punish repeated overdrafts or counsel customers to explore alternatives to relying on overdraft protection, for example, by suspending overdraft protection or offering a loan to the customer as an alternative; and

(5) ATM screens and teller terminals show an available customer balance that fails to distinguish between the customer's actual ledger balance and the customer's available balance with bounce protection.

The scope of the proposed guidance, however, is broad enough to include *all* types of overdraft protection programs. This would include, for example, (i) banks who have an established in-house practice of paying insufficient funds items based on the amount of the proposed overdraft and the institution's prior experience with the customer[3], and (ii) more benign forms of vendor overdraft protection programs such as COPS℠.[4] It is inappropriate that the proposed guidance lumps all these types of overdraft protection services together when addressing certain overdraft protection program concerns that are generally identifiable only with

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[3] Comment letters filed by Bank One, N.A., Chase Manhattan Bank USA, NA and Wells Fargo in response to the December 9, 2002 Regulation Z comment solicitation suggest these institutions operate internally developed programs that automate the NSF payment decision without, however, relying on disclosure or advertising of this automation process. Bank One's January 27, 2003 comment letter noted "checking account overdraft protection is traditionally in the form of a committed line of credit governed by Regulation Z. However, distinguished from that form, Bank One occasionally pays checks even though the checks overdraw customers' accounts as a courtesy to customers. To do this, Bank One employs an automated system, which uses several criteria to evaluate a customer's relationship with Bank One, as a preliminary decisioning tool. This system is then used to pay or return a check, or may be superceded through subsequent manual intervention." Bank One reported that it "prefers not to advertise this process."

Chase Manhattan's January 27, 2003 comment letter noted that "for deposit customers who do not have formal overdraft protection products, a bank may establish an internal limit up to which it will pay overdrafts. The practice of using internal limits involves three features that distinguish it from credit transactions covered under TILA: (1) the bank neither advertises the fact that overdraft limits exist nor enters into any agreement with the customer regarding overdrafts that the bank will pay, and therefore the bank has no obligation to pay the overdrafts, (2) the overdraft incurred is immediately due and payable, and (3) the bank charges an overdraft fee regardless of whether it pays or doesn't pay the item. Chase believes that if any (much less all) of the preceding three factors is present, the practice is not covered by TILA."

Wells Fargo's January 27, 2003 comment letter requested "that the Board explicitly recognize the distinction between "bounce protection" programs and routine decisions to pay or return items presented for payment on an account that are not publicly promoted."

[4] In comparison to traditional flat line vendor overdraft protection products, the COPS℠ program, as PTC recommends product deployment, (1) is not actively publicized or marketed to customers; (2) requires immediate payment of overdrafts; (3) discourages repeated use of courtesy overdraft services by reducing or shutting off overdraft privileges, if, for example, the overdraft program is used as a "cash management" tool by the customer; (4) does not inform customers that they have a credit limit of $X; and (5) relies on an active risk matrix to automate the pay/return decision process to help determine a courtesy overdraft limit tailored to each individual account.

flat line vendors. Accordingly, we suggest that the agencies more clearly define what constitutes an "overdraft protection program" for purposes of the proposed guidance, and redirect the applicable supervisory guidance to the appropriate party(ies). The overdraft practices of flat line bounce protection vendors are not representative of the overdraft practices of the financial services industry as a whole. For your convenience, we have arranged our comments in the same order as the sections identified in the proposed guidance.

**INTERAGENCY GUIDANCE ON OVERDRAFT PROTECTION PROGRAMS**

*Safety and Soundness Considerations*

The section on safety and soundness considerations focuses primarily on the reporting of income and loss recognition on overdraft protection programs. We believe this section mistakenly treats overdrafts as if they are *committed lines of credit*. This approach presumably reflects the agencies' inaccurate perception that bounce protection is not truly discretionary because of the frequency or volume of institutions exercising their discretion through automation to pay NSF items as overdrafts. We believe the agencies should treat losses attributable to overdrafts as operational in nature, rather than credit based, and the proposed guidance should be revised to reflect this approach.

For example, the proposed guidance notes that overdraft balances should be reported as loans, and overdraft losses (except those attributable to fees) should be charged off against the allowance for loan and leases losses. In addition, if a financial institution informs its customers about the actual amount of overdraft protection available, the financial institution would need to report these available amounts as "unused commitments" in regulatory reports. Since *ad hoc* overdrafts are not considered credit under the two part definition of "credit" in Regulations B and Z, overdrafts should not be recorded as loans on a financial institution's books. Similarly, since overdrafts are drawn against deposit funds, the losses attributable to overdrafts should be reported as "deposit loss reserves," rather than potential loan defaults categorized under the allowance for loan and lease losses. Finally, *ad hoc* overdrafts can never be "unused commitments," because no binding contractual commitment is being made by financial institutions to pay the overdraft items. By dictating that financial institutions treat *ad hoc* overdrafts as loans on financial statements and regulatory reports, the agencies are egregiously mischaracterizing the contractual obligations of financial institutions in the payment of discretionary *ad hoc* overdrafts. Changes regarding income and loss recognition principles, such as the 30-day charge off period, would be better addressed by amending call report instructions, rather than issuing blanket statements under the rubric of Kafkaesque "best practices" guidance.

*Legal Risks*

The proposed Interagency Guidance on Overdraft Protection Programs alerts financial institutions to the legal risks associated with overdraft protection programs, including the Truth in Lending Act ("TILA"), the Equal Credit Opportunity Act ("ECOA"), and the Electronic Fund Transfer Act ("EFTA"). We believe the proposed guidance regarding these acts and their implementing regulations is a huge departure from and largely inconsistent with past federal consumer protection rulemakings. As such, we request that the agencies revise these provisions

so that the proposed overdraft protection guidance more accurately reflects the current state of the law.

TILA and Regulation Z. TILA, which is implemented by Regulation Z, requires creditors to give cost disclosures in connection with extensions of consumer credit. TILA and Regulation Z apply to creditors that regularly extend consumer credit that is subject to a finance charge or that is payable by written agreement in more than four installments. Fees for paying overdraft items are currently *not* considered finance charges under Regulation Z if the financial institution has not agreed in writing to pay any overdrafts. In fact, Regulation Z specifically states "charges imposed by a financial institution for paying items that overdraw an account, [are not finance charges] unless the payment of such items and the imposition of the charge were previously agreed upon in writing." It is instructive to note that the current provision of Regulation Z is virtually unchanged from the version originally promulgated by the Federal Reserve Board in February 1969. Thus, from its inception in 1969, Regulation Z has not treated an overdraft charge as a finance charge unless payment of the overdrawn item and the imposition of the overdraft fee were agreed to in writing in connection with a formal overdraft plan. In any event, the question of whether there is an agreement in writing to pay overdrafts is subject to determination under state law and can only be evaluated on a case-by-case basis. We note that the FRB has repeatedly declined to determine in the past whether a written agreement to pay an overdraft exists. [*See* Official Staff Commentary to Regulation Z Section 226.2(a)(13)-1 (state law governs when contractual obligation is created); Official Staff Commentary to Regulation Z Section 226.17(c)(1) (legal obligation of parties is determined by applicable state law or other law)]

The proposed guidance also incorrectly states that "[w]hen overdrafts are paid, credit is extended." PTC has routinely counseled clients providing courtesy overdraft services that the obligation of immediate repayment (within several days) ensures that an *ad hoc* overdraft is not considered "credit" for purposes of Regulation Z. This is because Regulation Z defines credit as "the right to defer payment of debt or to incur debt and defer its payment." Up to this point, pertinent FRB rulemakings issued on the subject of credit have reached a similar conclusion, *i.e.*, that overdrafts are generally not considered credit within the meaning of Regulation Z. In this regard, the agencies should consider the FRB rulemaking amending the Regulation Z Official Staff Commentary to include payday loans as "credit." [*See* 65 Federal Register 17129,17131, March 31, 2000] In the payday truth-in-lending rulemaking, the Federal Reserve Board notes that "the routine delay in debiting a consumer's deposit account during the check collection process does *not* constitute credit." [65 Federal Register 17129,17131, March 31, 2000, *emphasis added*] The Official Staff Commentary to Regulation Z further notes that payday loans are a form of credit because the "parties agree that the check will not be cashed...until a designated future date." In other words, payday loans include the critical element of the right to defer payment of debt because the payday lender has agreed not to cash the check for a certain period of time. *Ad hoc* overdrafts cannot be seen as extensions of credit because no similar agreement exists between the institution and the consumer.

The agencies should also consider a 2001 OCC rulemaking regarding national bank non-interest charges and fees (including deposit account service charges). [*See* 66 Federal Register 34784, July 2, 2001] The 2001 OCC rulemaking clarifies the definition of interest to provide that

"fees a [national] bank charges for its deposit account service... including overdraft and returned check charges... are not covered by the term 'NSF fees' as that term is used in Section 7.4001(a)." [66 Federal Register 34784, July 2, 2001] The effect of the OCC rulemaking is to make clear that a fee a national bank charges to pay a customer's inadvertent check overdraft is not "interest" for purposes of 12 U.S.C. Section 85, the provision governing the interest rate national banks may charge. The payment of interest is an indicia of credit.[5]

The use of the term "credit" in the proposed guidance is inconsistent with previous rulemakings issued in the last several years by the OCC and the FRB. Only the FRB has the authority to define the meaning of credit under Regulation Z and prescribe appropriate rules and regulations. Any effort to characterize *ad hoc* overdrafts as credit within the meaning of the two-part definition in Regulation Z in the context of so-called "best practices" guidance is contrary to the Administrative Procedure Act.[6]

ECOA and Regulation B. Under the ECOA and its implementing Regulation B, creditors are prohibited from discriminating against an applicant on a prohibited basis in any aspect of a credit transaction. The proposed guidance states unequivocally that ECOA and Regulation B apply to overdraft protection programs. Again, the proposed guidance fails to support the federal financial institution supervisory agencies' determination that *ad hoc* courtesy overdrafts are credit for purposes of Regulation B.

*Ad hoc* overdrafts are not extensions of credit under ECOA or Regulation B. Regulation B applies to applicants for credit. Regulation B Section 202.2(j) defines "credit" as "the right granted by a creditor to an applicant to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment therefor." The Official Staff Commentary to Regulation B emphasizes that the regulation:

> Covers a wider range of credit transactions than Regulation Z (Truth in Lending). For purposes of Regulation B, a transaction is credit if there is a **right** to defer payment of a debt—regardless of whether the credit is for personal or commercial purposes, the number of installments required or repayment, or whether the transaction is subject to a finance charge. [Comment 2(j) (*emphasis added*)]

The Official Staff Commentary reinforces the premise that for a transaction to be considered "credit" under Regulation B, there must be a right to incur debt and defer its repayment or the right to defer payment of existing debt. *Ad hoc* overdrafts have never been considered to be extensions of credit under Regulation B for the simple reason that a financial institution is under no obligation to allow the overdraft in the first place. Financial institutions have historically

[5] Three federal district court cases have found that NSF fees are not interest: *First Bank v. Tony's Tortilla Factory, Inc.*, *Nicholas v. Deposit Guaranty National Bank*, and *Video Trax, Inc. v. Nationsbank, N.A.* The OCC in an Amicus Curiae brief in *Nicholas* took the position that NSF fees (regardless of whether the NSF item is paid or not) are not interest (because such fees are not imposed in connection with a credit transaction) and do not violate the National Bank Act or Mississippi usury law.

[6] This statement would also true for the "best practices" guidance applicable to Regulation B characterizing *ad hoc* overdrafts as credit.

reserved the right to pay NSF items based on the individual facts and legitimate business considerations of each situation. Consequently, the discretionary payment of an overdraft should not be considered "credit" under Regulation B. As vociferously as we object to the fundamental change regarding the meaning of "credit" for purposes of the proposed Regulation Z overdraft protection guidance, we also object to this fundamental change regarding the regulatory meaning of "credit" for purposes of the overdraft protection guidance applicable to Regulation B.

EFTA and Regulation E. EFTA and its implementing Regulation E require a financial institution to provide consumers with account-opening disclosures and to send a periodic statement for each monthly cycle in which an electronic fund transfer has occurred (or at least quarterly if no transfer has occurred). If a consumer under an *ad hoc* overdraft protection program could overdraw an account by means of an ATM withdrawal or point-of-sale debit card transaction, both transactions would be considered under the proposed guidance as electronic fund transfers subject to EFTA and Regulation E. Consequently, periodic statements provided to consumers would need to be readily understandable and accurate regarding debits made, current balances, and fees charged. Terminal receipts would also need to be readily understandable and accurate regarding the amount of the transfer. These are the ordinary EFTA and Regulation E compliance measures that are required for all types of electronic funds transfer transactions.

We believe the agencies' revised approach to Regulation E compliance places too much emphasis on the method of access or the type of transaction that is responsible for creating the overdraft. Instead, common sense would seem to dictate that overdrafts be treated simply as a result of the deposit account product itself. We note that until the proposed overdraft protection guidance was issued on May 28, 2004, the FRB had previously acknowledged that an ATM-based overdraft transaction was akin to a transfer within the institution from one account of a depositor to another account of that same depositor, a type of transaction that generally is not subject to Regulation E compliance in the first instance. [*See* 12 C.F.R. §205.3(c)(5)(I)]. Regulation E has to do principally with transfers between the institution's customer and the third party, *not* inter-account transfers within the institution.

The Official Staff Commentary to Regulation E makes clear that the initial electronic fund transfer disclosure is not required to disclose an account overdraft fee. 12 C.F.R. Section 205.7(b)(5)-1 provides, in pertinent part, as follows:

> An institution is required to disclose all fees for EFT's or the right to make them. Other fees (for example, minimum-balance fees, stop-payment fee, or account overdrafts) may, but need not, be disclosed (but see Regulation DD, 12 C.F.R. Section 230).

The previous version of the Official Staff Commentary more emphatically stated the case for why overdraft fees are not required to be disclosed. As you know, the previous iteration of the Regulation E Official Staff Commentary appeared as a question-and-answer format. Comment Q 7-15, which was the standard for compliance until January 1, 1997, provided as follows:

> 7-15 Q: *Disclosure of charges — stop-payment/dishonor/overdraft.* Does the regulation require disclosure of charges for stop-payment orders, dishonor or overdrafts?

A. No. These are not charges for electronic fund transfers or for the right to make such transfers. Disclosure is permissible, however.

We believe the Federal Reserve Board would need to initiate a formal rulemaking to expand the coverage of Regulation E to require disclosure of a fee for *ad hoc* overdraft payments. We note that only the FRB has the authority to prescribe regulations that carry out the purposes of EFTA.

*Best Practices*

The proposed Interagency Guidance on Overdraft Protection Programs establishes certain "best practices" regarding courtesy overdraft programs to promote consumer understanding, limit consumer dissatisfaction, encourage appropriate use, and minimize a financial institution's credit and reputation risks. As described in the proposed guidance, "best practices" are generally not rules of law, but rather are patterns of behavior "currently observed in or recommended by the industry" that financial institutions "should take into consideration." Unfortunately, however, the proposed guidance fails to note how such "best practices" will be evaluated by institution examiners. We believe any final issued guidance should more clearly define what, if any, enforcement mechanisms are in place relative to this "best practices" guidance. Obviously, a worst case scenario would require financial institutions' strict adherence to these practices at the threat of formal examiner criticism.

There is also a lack of statutory or regulatory precedent that supports the establishment of these "best practices." There are no laws, rules, or regulations which refer to compliance obligations *vis-à-vis* so-called best practices. Best practices would involve a subjective mix of business judgment, accounting practices and policies, industry customs, economic conditions and expectations, and other public policy considerations. As a result, financial institutions, as well as bounce protection vendors, are given very little definitive guidance on which safe and sound business decisions can be made and justified. In addition, this imprecise "best practices" guidance makes it virtually impossible for financial institutions to establish effective internal controls as required under Generally Accepted Accounting Principles ("GAAP") and/or Section 404 of the Sarbanes-Oxley Act of 2002, where applicable.

PTC believes that the agencies need to reconsider the "best practices" guidance in total, as many of the described practices would simply result in "disclosure overload." "Disclosure overload" is created by inundating consumers with too much information at any one time. As a result, consumers cannot determine what course of action is appropriate to take. The best way to eliminate "disclosure overload" is to simplify the number of disclosures made and to clarify the contents of the disclosures. As written, the "best practice" guidance only further "muddies the waters," creating additional consumer confusion about overdraft protection programs instead of greater awareness.

PTC's comments regarding the agencies' "best practices" guidance is arranged based on the order of the individual bullets, with comment provided only on those recommended best practices that should be reconsidered.

Marketing and Communications with Consumers

• **Fairly represent overdraft protection programs and alternatives.** There is a substantial cost involved in explaining to consumers the costs and advantages of other available overdraft services or credit products. In addition, not all consumers will qualify for an unused line of credit, and not all banks will be able to offer alternative credit options. Financial institutions will be placed in a precarious position because the costs and advantages of any given credit alternative will be dependent upon the individual consumer's personal habits and behavior. Consequently, we do not believe that presenting consumers with viable alternatives to *ad hoc* courtesy overdraft programs is economically feasible.

We also note that many institutions are now charging a fee for the transfer of funds from a line of credit to the transaction account, as permitted under federal regulations. Under this scenario, the use of the line of credit becomes more costly than just the finance charge. How would the agencies propose that financial institutions disclose this alternative to an overdraft protection program? The agencies should not force financial institutions into this "catch-22" disclosure dilemma.

• **Clearly explain discretionary nature of program.** The proposal suggests that a financial institution should describe the circumstances in which the institution would refuse to pay an overdraft or otherwise suspend the overdraft program. This would require a financial institution to describe with particularity the circumstances under which the institution retains the discretion to pay or not pay certain items. This is problematic for a number of reasons. First, it opens the door to consumer fraud by allowing consumers to determine with certainty which items will be accepted and paid. Second, consumers will presume that if they satisfy the institution's criteria, the NSF items will be automatically paid. Third, such an arrangement could be viewed as creating a contractual commitment for the institution to pay overdrafts. Finally, the discretionary aspects of the program could be considered as a part of the institution's intellectual property, and disclosing these aspects could affect the institution's ability to compete in the marketplace. We note that Webster's Ninth New Collegiate Dictionary defines "discretion" as "the power of free decision or latitude of choice within certain legal bounds." If the "discretionary" nature of overdraft protection programs is to be maintained, financial institutions should not be forced to disclose the specific reasons or rationale behind their overdraft decisions.

• **Clearly disclose program fee amounts.** The proposed guidance would require that financial institutions restate the dollar amount of the fee for each use of a courtesy overdraft program in all promotional materials for such programs, rather than just stating that the standard NSF fee will apply. We believe this "best practice" would be best regulated under the Truth in Savings Act ("TISA") and its implementing Regulation DD. The purpose of TISA and Regulation DD is to assist consumers in comparing deposit accounts offered by depository institutions, principally through the disclosure of fees and other account terms. Consequently, Regulation DD, rather than the proposed interagency guidance, should determine what account information is provided to consumers. We note that on May 28, 2004, the FRB issued proposed rule amendments to Regulation DD that would regulate the adequacy and uniformity of information provided to consumers who overdraw their accounts. This particular bullet might be better addressed within this proposed Regulation DD rulemaking.

• **Demonstrate when multiple fees will be charged.** Like the bullet above, this guidance would also be better addressed under TISA and Regulation DD.

• **Explain check clearing policies.** A financial institution would be required to disclose clearly the order in which checks are paid and other transactions are processed. Like the bullet requiring financial institutions to explain the discretionary nature of their overdraft protection programs, this "best practice" involves disclosing the bank's intellectual property and encourages fraud, such as check kiting. Moreover, the disclosure only serves as a device to allow consumers to claim that an institution has "wrongfully dishonored" a specific returned item, when the consumer lacked the necessary funds to process the item in the first place.

• **Illustrate the type of transactions covered.** The proposed guidance would require that financial institutions clearly disclose the types of transactions that could give rise to fees under a courtesy overdraft program, such as checks, ATM, or point-of-sale. This is another instance where we believe that the agencies have placed too much emphasis on the method of access or the type of transaction that is responsible for creating the overdraft item. Retailers, not financial institutions, are driving the payment presentment arena. With the advent of Check 21 and accounts receivable conversion ("ARC"), transaction channels are becoming more varied and instantaneous.[7] In addition, electronic payments are increasingly making up a large portion of the retail payment system. According to data collected and analyzed by the Federal Reserve Board, 4.8% fewer checks will be processed in 2003 than in 2002, and 9% fewer checks will be processed in 2004. Similarly, a 2003 survey conducted by Dove Consulting Group Inc. and the American Bankers Association (the "Dove Study") also provides proof that the payments system is rapidly moving towards more electronic payments. According to the Dove Study, credit and debit cards will account for 52% of transactions at the point of sale for 2003, while cash and checks combined will account for 47%. These numbers have nearly inverted since 2001, when cards were used for 47% of purchases and paper was used for 51%. The Dove Study also points out that debit card transaction percentage grew from 21% in 1999 to 31% in 2003. Most experts believe that the trend towards electronic payments over paper is likely to continue into the immediate future. As a result, we believe that the agencies should primarily focus on deposit account disclosure (a realm within financial institutions' remit), rather than emphasizing the various types of transactions or method of access pursuant to which overdrafts may occur (this latter scenario no longer being within financial institutions' exclusive control as a result of retailers' increased presence in the payment presentment arena).

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[7] A July 13, 2004 article in America Banker Online reports that ARC has become the most commonly used electronic check format. ARC volume could reach up to 1 billion transaction in 2004. ARC, along with WEB (Internet-initiated transactions, TEL (phone-initiated transactions), POP (point-of-purchase payments), and RCK (returned checks) made up 21.2% of the 2.23 billion ACH transactions recorded in the second quarter of 2004. The article notes that financial experts predict ARC usage will continue to grow. [Steve Bills, *Nacha Report: ARC Overtakes Web for E-Payments*, American Banker Online, July 13, 2004]

Program Features and Operation

• **Alert consumers before a non-check transaction triggers any fees.** As the previous bullet notes, electronic payment channels are becoming more widespread. As a result, this proposed "best practice" will not always be technologically feasible. Under certain circumstances, such as with electronic check conversion, it will be impossible for financial institutions to provide advance notice. We suggest that the banking agencies eliminate this bullet based on the recommendation's pure impracticability.

• **Prominently distinguish actual balances from overdraft protection funds availability.** This "best practice" would place community banks at a disadvantage to large banks who have the technological and financial capabilities to provide such disclosures. In addition, providing consumers with overdraft protection program funds availability actually *encourages* consumer overdrafts and *discourages* fiscal responsibility.

There is also the issue of consumer confusion. An "actual balance" seems to imply that there is an exact amount that is in the account at any given point of time. Because transactions may occur at any time, and the account is always subject to any outstanding items, the term "actual balance" is a misnomer with severe temporal restrictions. The consumer confusion that could occur as a result of distinguishing between "actual balances" and "overdraft funds availability" would be similar to that caused by the FRB under Regulation CC. Regulation CC requires banks to disclose the date funds deposited by a consumer are made available for withdrawal by the consumer. This objective seems simple enough. Yet, Regulation CC has one set of general rules regarding the availability of funds, one set of rules describing exceptions to the general rules, and an entirely different set of rules regarding ATM deposits. All these Regulation CC disclosures do nothing but serve to confuse consumers as to the actual amount of funds available at any one time in their accounts. Like the required Regulation CC disclosures, we believe implementation of this proposed "best practice" would only enhance consumers' confusion as to the available balance of their deposit account funds.

• **Promptly notify consumers of overdraft protection program usage each time used.** This proposed "best practice" would require (i) prompt consumer notification of *each* courtesy overdraft program use, (ii) re-disclosure of the terms of the courtesy overdraft protection program upon the consumer's first use, and (iii) providing the consumer with advance notice when use of a courtesy overdraft program will be suspended or terminated.[8] While the intention of the banking agencies in seeking greater disclosure regarding the use and termination of overdraft protection programs is noble, actual implementation would be a first in the field of federal consumer financial services regulation. No other banking product, including credit cards, cashier's checks, money orders, stop payments, monthly service charges, ATM fees, etc., is subject to all these notice and/or disclosure requirements. Moreover, the reprogramming of computers to

[8] According to the proposed guidance, the notification would need to disclose the transaction that resulted in the overdraft, the overdraft amount, any fees associated with the overdraft, the amount of time consumers have to repay the overdraft, and the consequences of not paying the overdraft within a given time frame.

accommodate providing these various notices and disclosures might be significant enough to serve as a knock out punch precluding many community-based depository institutions from offering *ad hoc* overdraft protection services. Establishing "best practices" disclosure that only the nation's largest banks can cost effectively implement further accelerates banking industry consolidation and the loss of independent community banks, the linchpin of American economic resiliency compared to other OECD economics. We believe this paternalistic approach towards overdraft protection programs is unwarranted, cost-prohibitive, and unnecessarily duplicative of other protections already provided to consumers.

We should also note that providing consumers with "advance" notice of termination or suspension is largely impossible. A financial institution cannot adequately gauge when a consumer is about to write a NSF item. Moreover, an account's "qualifying" status may change over time, and usage of the program may be sporadic. Accordingly, a financial institution can only determine whether a consumer "qualifies" for a overdraft protection program at the time a single item is presented for payment against insufficient funds. Providing such notification may also confuse the consumer into believing that he/she has a committed line of credit, rather than access to a discretionary service.

• **Monitor overdraft protection program usage.** Like the bullet above, this "best practice" also reflects the banking agencies' misguided paternalism to consumers of financial services. This recommendation is tantamount to Wal Mart suggesting what type of groceries a consumer should buy or the cable company telling the consumer what television programs are appropriate for viewing. Financial institutions are not formed for the purpose of providing financial counseling services to consumers. In a free market economy where rule by Adam Smith's invisible hand should be paramount, the responsibility for fiscal soundness should rest with the individual consumer. Courtesy of the Bank Secrecy Act and the USA Patriot Act, banks have become allies of the federal government in the war against terror and financing of terrorist activities. That well-founded rationale has no parallel in George Orwell-like Big Brother initiatives requiring banks, under the specter of federal bank examiners' supervisory and enforcement powers, to determine when the American consumer should no longer qualify for *ad hoc* overdrafts. We recommend that this bullet be deleted.

• **Fairly report program usage.** The meaning of this bullet is somewhat unclear. If the intention of this "best practice" is simply to punish flat line bounce protection vendors who "promote" their overdraft protection programs to consumers, then we have no issue with this bullet. However, the word "promoted" is not defined. After the issuance of this guidance in final form, an argument could be made that all overdraft protection programs will be "promoted" because the program will be brought to the consumers' attention through the best practices disclosure process. If the agencies tend to view the word "promoted" in this broader context, we believe this bullet is misguided. Suggesting that an institution should not report negative consumer information simply because the institution has an overdraft protection program is nonsensical and against the principles of safety and soundness. Accordingly, this bullet should be clarified to express the agencies' true intent with regard to the fair reporting of overdraft protection program usage occurring in the context of heavily marketed bounce protection programs.

**CONCLUSION**

While Profit Technologies' comments regarding the proposed Interagency Guidance on Overdraft Protection Programs were thorough, Profit Technologies finds the fundamental premise underlying the proposed rulemaking to be sound. That is, the rulemaking's *raison d'etre* is to curb bounced-check or overdraft protection programs that are marketed to increase the volume of overdrafts to generate additional fee income for the institution. Long before the FRB and the other four federal financial institution supervisory agencies acting under the aegis of the Federal Financial Institutions Examination Council issue a proposed rulemaking for "best practice" in overdraft administration, Profit Technologies counseled banks to take the high road in deployment of Profit Technologies' COPS℠. We at Profit Technologies have never stressed the marketing of COPS℠. When Comptroller of the Currency John D. Hawke, Jr. gave his speech before the American Bankers Association in Hawaii on September 22, 2003, we knew that we were on the right side of the fence when the OCC Comptroller said that day "bounce protection is another accident waiting to happen," continuing his remarks that "today we see some vendors aggressively marketing new programs to banks under which overdraft protection would be affirmatively promoted as a variety of short-term credit, much like the product offered by so-called payday lenders." The approach of the proposed rulemaking levels the playing field by eliminating, again in the words of the Comptroller's speech given to the ABA in Hawaii, "the shoddy practices of a few" that "could result in regulatory burdens for everyone."

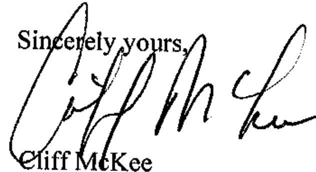
Thank you for the opportunity to submit comments on the proposed Interagency Guidance on Overdraft Protection Programs. We hope that the final guidance issued reflects a more balanced approach to overdraft protection program guidance. We believe that the "sins" of flat line bounce protection vendors should not be held against all institutions that have *ad hoc* overdraft protection services. Obviously, consumers like courtesy overdraft programs, and adoption of the proposed guidelines "as-is," only serves to punish *all* users and providers of such services.

We have one final thought. As an alternative to issuing revised final guidance on overdraft protection programs, the agencies might consider regulating bounce protection vendors by making OCC Bulletin 2001-47 (Third-Party Relationships) an uniform interagency statement. OCC Bulletin 2001-47 provides guidance to national banks on managing the risks that arise from business relationships with third parties. The OTS has adopted substantially similar guidance through Thrift Bulletin 82 issued on March 19, 2003. OCC Bulletin 2001-47 also addresses the OCC's supervisory approach in regard to such third-party relationships. The OCC treats as subject to the Bank Service Company Act, 12 U.S.C. 1867(c), situations in with a national bank arranges by contract or otherwise, for the performance of any applicable internal bank operations. As a result, the OCC has the authority to examine the operations of the third-party service provider to the same extent as if the operations were performed by the national bank. The OCC may examine safety and soundness risks, the financial and operational viability of the third-party vendor, compliance with applicable consumer protection and fair lending laws, and whether the third-party engages in unfair or deceptive acts or practices in violation of federal or applicable state law. Consequently, we believe that OCC Bulletin 2001-47 provides a viable regulatory alternative to the proposed guidance, as well as an effective enforcement mechanism that may be used to punish unscrupulous flat line bounce protection vendors.

PTC recognizes that the Bank Service Company Act is rarely invoked by the federal financial institution regulatory agencies. Nevertheless, our recommended approach towards overdraft protection oversight is not entirely without precedent. We note that the agencies now routinely apply Section 5 of the Federal Trade Commission Act to address unfair and deceptive acts or practices committed by financial institutions. However, this has not always been the case. It took the agencies nearly *twenty-five years* after Congress passed the Federal Trade Commission Improvement Act of 1975 to uniformly agree that Section 5 of the Federal Trade Commission Act applied to financial institutions. We believe the Bank Service Company Act , like Section 5 of the Federal Trade Commission Act , is a desirable enforcement tool, simply awaiting the agencies' good use.

Thank you again for the chance to comment on the proposed overdraft protection program guidance.

Sincerely yours,



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