

From: Kevin Christensen
Subject: Electronic Fund Transfers

Comments:

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Proposal: Regulation E - Electronic Fund Transfers

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

Re: Regulation E; Docket No. R-1343

Dear Ms. Johnson:

The SHAZAM network appreciates this opportunity to respond to the Request for Comment issued by the Federal Reserve Board (Board) regarding proposed amendments to Regulation E and its staff commentary. Since 1976, the SHAZAM network's member-owned structure has stayed true to our mission to provide our financial partners with an independent source and a voice in the electronic payments industry. We have dedicated our organization to providing and enhancing the opportunity for affiliated community financial institutions to compete effectively and profitably in the marketplace through the delivery and support of quality, comprehensive, and timely electronic services. SHAZAM provides electronic funds transfer (EFT) services to nearly 1,600 community financial institutions in 30 states.

Additionally, SHAZAM provides merchant processing services for approximately 7,000 merchants. SHAZAM believes the proposed regulatory changes would be costly and burdensome for financial institutions and their processors. For example, many small financial institutions, including 14 percent of SHAZAM's participants, do not have the ability to provide any balance information to their processor when approving transactions, thus making it impossible for these institutions to provide a notice each time the customer may overdraw his or her account. Instead, many institutions set a predetermined daily limit that is available to each of their cardholders regardless of their actual balances. If the proposal is approved in its current form, these institutions would be required to upgrade their technology at a significant cost to provide us with balance information, or no longer charge for the overdraft services they provide for their customers. Additionally, many community financial institutions and their processors do not have the ability to provide real-time

balances when approving transaction. Even those institutions that do provide balance files throughout the day still have time periods where balances are not accurate and accounts can be overdrawn. It would be impossible for many institutions or processors to comply with this requirement, despite their best attempts.

When financial institutions are unable to process transactions due to a technical problem or natural disaster, they may ask SHAZAM to perform stand-in processing. This means SHAZAM processes their transactions based on pre-established criteria without access to any of the financial institutions' files, including balance information. If this proposal is passed in its current form, stand-in processing would no longer be an option and customers would have all transactions declined in these situations, regardless of their account balances. The only other alternative available would be for financial institutions to allow their customers to overdraw their account during this time period without charging any overdraft fees.

As demonstrated in the above examples, increased costs resulting from the proposed changes would be passed down to consumers and potentially drive consumers away from depository institutions and toward less scrupulous payment system providers. Finally, to manage risks, depository institutions may be compelled to deny some customers access to these convenient products and services, further alienating these consumers. OPT-OUT OPTION SHAZAM believes the final rule should allow financial institutions to offer customers the choice to opt out of the overdraft services rather than require customers to opt in. We feel it would be appropriate to provide consumers with a simple disclosure and an opportunity to opt out before applying the program to their accounts. Many community financial institutions already provide this option for their customers. From a technical and operational perspective, it is more feasible to implement a simple opt-out that applies to all transactions on an account. In addition, allowing customers to opt-out of overdraft services will meet the spirit of the regulation while not inconveniencing those customers that wish to have the benefits of an overdraft program.

We also believe the proposal raises a number of questions that need to be addressed. For example, what is considered a "reasonable" time to allow customers to opt out? During the interim, must the institution reject any transaction that would otherwise overdraw their accounts? For a joint account, could one party bind all accountholders, or would all accountholders have to agree to opt out? And, would consumers need to opt out for each account, or would an opt-out apply to all of their accounts with the institution? These elements should be addressed in the final rule after additional public feedback. If a customer opted out but later performed transactions that overdrew his or her account, the institution might be compelled to close the account, deny continued use of a debit card, or otherwise restrict services as a way to control risk and ensure safe and sound operations. Informing customers about alternatives to overdraft protection programs might help resolve this, but not all customers would be eligible for these alternatives or willing to take the steps needed to qualify. PARTIAL OPT-OUT While requiring financial institutions to offer an opt-out from overdraft protection is acceptable, applying the opt-out to only one-time debit card purchases and ATM withdrawals seems unworkable. A partial opt-out would be so burdensome and challenging that many community financial institutions would abandon overdraft protection services entirely and simply return or reject any transaction that would overdraw an account. Without overdraft protection services in place, consumers would face a virtually identical fee from their financial institutions but would also face additional merchant fees, negative

entries on credit reports or check verification systems, declined transactions, and more limited payment options. The final rule should allow institutions to decline overdraft services for all debit card transactions if the consumer declines the services, and should not have to determine application of the overdraft service based on whether the transactions are recurring or one-time transactions or for bill pay or purchases. The final rule should not, as proposed, require institutions to decline ATM withdrawals and one-time purchases if the consumer chooses to decline overdraft services. It is not possible for financial institutions to distinguish between debit card purchases and debit card bill payments, nor between recurring and one-time debit card bill payments. If the rule is adopted as proposed, institutions would not be able to avoid liability for violations they cannot prevent. While a customer might believe that opting out would avoid a \$30.00 fee for a \$2.00 cup of coffee, he or she would be unpleasantly surprised when cable service is cut off for lack of payment because the charge was set up using a debit card or recurring payment, and the transaction would have overdrawn the account and was rejected. SHAZAM strongly opposes this partial opt-out and urges the board to withdraw this element of the proposal. It is not operationally feasible for most institutions to apply a partial opt-out. For many community financial institutions, such technology is non-existent. Therefore, if the final rule mandates a partial opt-out, it would become an effective barrier that would prevent many community institutions from continuing to offer overdraft protection service at all. DEBIT HOLDS A debit hold occurs when a consumer uses a debit card for a transaction but the final amount is unknown when the transaction was initially authorized. Typically, the hold remains in place until the transaction settles. Assessing an overdraft fee while the hold is in place would be prohibited by the proposal if the hold amount exceeds the actual transaction amount. This prohibition would not apply in instances where there were insufficient funds in the account to cover the transaction. The prohibition applies only when the hold itself caused the overdraft, and there were sufficient funds to cover the transaction amount. Additionally, it should be noted that merchants typically use a merchant processor for card-based transactions. There is little regulation or regulatory oversight of merchant processors. As a result, there is no way to effectively enforce the proposed restrictions on debit holds. Furthermore, financial institutions cannot be held responsible for the actions of merchants or merchant processors. SHAZAM supports the development of materials that can easily and clearly explain holds to the average consumer. Since holds originate at the merchant level, merchants should be required to provide the information to consumers at the time the hold is placed. At present, the understanding of holds, what risks they are designed to address, how they operate, where they originate, what impact they have and how to best explain them to consumers needs much further investigation and study before rules are imposed. SHAZAM agrees that an exception for when the actual transaction would exceed the hold amount is appropriate. However, if a hold is in place, the proposal does not designate how subsequent transactions would be handled. For example, if there is a hold for one transaction and another transaction is processed that would exceed the balance with or without the hold, should that second transaction be processed, held, or treated as over-the-limit. In short, the proposal creates more problems than it solves. The ability to process holds and reconcile transactions in the manner required by the proposed rule will be operationally difficult and costly. In fact, it may be necessary for extensive manual processing to comply. For example, if a customer has opted out of overdraft services for debit cards and if a hold would cause any subsequent transaction to overdraw an account, the only workable solution for the institution may be to reject any future transactions until the hold is released. Many customers in this situation may have depleted

their account of funds before their debit card transactions clear, thus increasing their risk for potential loss. Alternatively, if the final rule were to require that all debit card holds are dropped within two hours, there would be significant consequences. For example, signature-based transactions are often authorized two to three days before the transaction actually clears the customer's account. During that time period, numerous PIN transactions, which are typically authorized and cleared in the same day, could take place. If a hold is not placed on the signature-based transactions, funds may not be available by the time the transaction actually posts to the account. This will result in increased loss for financial institutions, or it could lead some financial institutions to prohibit or phase out signature-based transactions. This will have serious and unintended consequences for signature-based card networks in addition to significantly reducing financial institutions' interchange revenue, which is higher on signature-based transactions. SHAZAM urges that any time-based restrictions regarding debit card holds be omitted from the final rule. IMPLEMENTATION TIMEFRAME Finally, SHAZAM requests the Board allow for an extended implementation timeframe for financial institutions, processors, and electronic funds transfer networks to comply with these regulatory changes. Many of these changes will require major system changes and in consideration of the current financial condition and regulatory responsibility, an extended period of time would be required to implement the necessary changes. CONCLUSION SHAZAM agrees that protecting consumers is important. However, SHAZAM is concerned that the "protections" that have been advocated by some may actually do more harm than good. Restrictions that become a costly barrier to serving customers - especially restrictions that do not apply universally but are limited to depository institutions - do not protect consumers. SHAZAM is especially concerned that developing rules that will apply only to depositories will create an environment for expanded litigation and will discourage many community financial institutions from continuing to offer financial products and services that most customers value and welcome. Perhaps more importantly, if these changes are adopted as proposed, elimination of providers from the market and reduced access to credit for consumers, especially marginal consumers, will be the likely result. While many community institutions offer alternatives such as overdraft lines of credit or balance transfer programs, those alternatives are not universal. And even where a community institution offers alternative means for a consumer to cover an overdraft, not all consumers will be eligible or will apply for them. As a result, the agencies should anticipate that these changes will, at a minimum, produce an increase in the level of rejected transactions and returned checks. When a check is returned, the customer still incurs a fee - along with the numerous other problems associated with a bounced check. In addition to the financial institution fee, a consumer will likely be charged a separate fee by the merchant, have to resolve the payment to the merchant, possibly have a negative mark on a credit report or check verification service, and may be compelled to remit future payments to that merchant using only cash, cashier's checks, or money orders. Additionally, there is the embarrassment associated with bouncing a check. One of the hallmarks of community financial institutions is the trust and respect that they have earned from their customers. Community institutions work very diligently to maintain that trust. New rules that pile on regulatory burdens and hamper the ability of community institutions to continue offering existing financial products and services are not, in the long run, beneficial for anyone. SHAZAM appreciates the opportunity to comment on the proposed regulation and we thank you for consideration of our comments.

Sincerely,

Kevin Christensen Vice