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By electronic delivery

March 30, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20 and C Streets, NW
Washington, D.C. 20051

Re: **Docket Number R-01343**
Proposed changes to Regulation E
Electronic Fund Transfer Act
74 Federal Register 28866

Dear Ms. Johnson,

Thank you for the opportunity to comment on the Federal Reserve Board's ("Board") proposed amendments to Regulation E, which implement the Electronic Fund Transfer Act ("EFTA"), published January 29, 2009 in the *Federal Register*. The proposal would limit the ability of a financial institution to assess an overdraft fee for paying ATM withdrawals and one-time debit card transactions that overdraw a consumer's account, unless the consumer is given the notice of a right to "opt out" of the payment of overdrafts and the consumer does not opt out. As an alternative approach, the proposal would limit the ability of a financial institution to assess an overdraft fee for paying ATM withdrawals and one-time debit card transactions that overdraw a consumer's account, unless the consumer has affirmatively consented or "opted in" to have such overdrafts paid. In addition, the proposal would prohibit financial institutions from assessing an overdraft fee if the overdraft would not have occurred but for a debit hold placed on funds in the consumer's account that exceeds the actual amount of the transaction.

The New York Bankers Association (NYBA) has consistently supported providing consumers with full disclosure regarding the products

and services offered to them by their financial institutions. We therefore commend the Board on its continuing efforts to ensure that financial institutions provide appropriate disclosures regarding the overdraft protection services they offer to their customers and agree that Regulation E is the appropriate regulation to address overdraft programs. To ensure, however, that this valuable consumer service continues to be available, we urge that the final rule provide financial institutions with flexibility in the design and implementation of their programs. In this regard, we recommend that the final rule permit banks latitude when providing an election not to cover debit card transactions in their overdraft service programs—permitting them to offer, in the bank’s discretion, one or both of an “all-in” account level choice or a partial election that properly recognizes how debit cards are used and processed given operational limitations. In addition, NYBA urges the Board to adopt a rule based on a customer’s right to opt out of overdraft service programs.

The final rule should also allow reasonable variations in terms and conditions depending on whether the consumer has elected or declined to accept overdraft services and permit the assessment of overdraft fees when a customer who has declined overdraft services overdraws an account by a transaction that the bank did not approve. Finally, should the Board adopt the prohibition against assessing an overdraft fee if the overdraft would not have occurred but for a hold related to a debit card transaction where the merchant was able to determine the amount of the transaction within a “reasonable time.” The “reasonable time” should be considered the end of the processing day; moreover, the regulation should require merchants to submit transactions by the end of the processing day of the authorization.

NYBA is comprised of the commercial banks and thrift institutions that do business in New York State. Our members employ almost 300,000 New Yorkers and have assets in excess of \$9 trillion.

I. Overview.

Financial institutions - who have always exercised discretion to cover overdrafts for good customers in appropriate circumstances - have now developed automated programs that have enabled them to extend this valuable courtesy to the vast majority of their customers, sparing those customers, in many instances, from the embarrassment and inconvenience of overdrawing their accounts. Adoption of such automated programs, have not only reduced costs associated with case-by-case assessment and manual intervention, but also has, importantly, promoted consistent customer treatment.

In most cases, the customer initiating a payment transaction wants to complete it and appreciates the bank making payment, even if there are insufficient funds. Indeed, a recent survey conducted by the American Bankers Association (see ABA Overdraft Fee Study, Ipsos U.S. Express Telephone Omnibus (July 11-13, 2008)) found that, of the 20 percent of consumers who had paid an overdraft fee in the last year, 85 percent were glad their bank did so. Despite these statistics, it is not surprising, that consumers interviewed by the Board have indicated a split in opinion with respect to their desire for overdraft protection services with respect to ATM and so-called “one-time debit card transactions,” as consumers overall cannot be expected to know of or understand the technical constraints that prevent **debit card purchases** from being reliably distinguished from **one-time debit card bill payments** let alone **recurring debit card-based bill payment transactions**. Moreover, it is understandable that a consumer may react negatively to the amount of an overdraft fee for a small purchase— until and unless he or she understands that it is not the small purchase, but rather the failure of the customer to manage his or her account balance, that incurs the fee. For only the customer knows at any given time what checks they have written, automatic payments they have authorized, and debit card transactions they have approved. Thus, the ultimate responsibility for avoiding overdrafts lies with the consumer. We urge, therefore, that any final rule enacted by the Board not create the incorrect impression that it is not necessary for consumers to keep track of their transactions and manage their accounts.

I. Regulation E is the appropriate regulation to address overdraft protection practices regarding debit card transactions.

In our August 4, 2008 comment letter regarding the Board’s earlier overdraft services proposal, NYBA urged that any new regulatory mandates for consumer protection for debit card transactions be evaluated within the established regulatory framework for electronic transactions, funds availability, and account disclosures, rather than through reliance on the Federal Trade Commission Act and UDAP standards. We commend the Board for recognizing that Regulation E (which sets forth the rights, liabilities and responsibilities of those participating in electronic fund transfer systems) is the appropriate regulation to address concerns related to overdrafts – particularly as much of the Board’s focus on overdrafts relates to debit card transactions covered under that regulation.

II. The final rule should permit banks latitude when providing an election not to cover debit card transactions in an overdraft protection program.

The Board has offered two alternative proposals related to a bank’s ability to link or decouple a customer’s choice to decline overdraft services

for “ATM withdrawals and one-time debit card purchases” with the customer also declining overdraft services for other types of transactions such as checks, ACH transactions, and recurring transactions. Under the “all-in” alternative, the bank would permit the customer to have all overdrafts paid (subject to the bank’s discretion). Under the alternative “partial” opt-out or opt-in, the consumer may choose to have ATM withdrawals and one-time debit card purchases declined, but have other transactions, such as checks, ACH transactions, and recurring transactions paid (subject to the bank’s discretion). In order to ensure that consumers continue to have access to overdraft services, we urge that the final rule include the ability for financial institutions to employ the “all-in” approach. Due to the operational challenges and limitations facing banks today, as well as confusion as to what transactions may or may not be covered under the “partial” opt-out or opt-in, failure to allow the “all-in” alternative in the final rule, could result in less access to valuable overdraft services that many consumers have come to value and expect as available to them.

- a) *Overdraft services should focus on customer account management and not payment method management. Banks and consumers should be allowed to harmonize the overdraft treatment of checks and check cards.*

Today, almost all debit cards that are suitable for purchases are identified with a major network brand. The cards themselves are often titled or marketed as “check cards.” In other words, they are promoted as doing the same things as checks do—only without the paper. In this regard, a consumer is able to conveniently make purchases, and/or pay bills separately or even on a recurring basis, via a check or check card. By the same token, both payment modes are as likely to incur merchant and payment recipient late fees for insufficient funds. Providing overdraft protection services for checks, but not for check cards, will not only cause consumer confusion, but also inappropriately places the emphasis on payment method management, instead of customer account management. This is, we believe, an irrational distinction, especially as the different devices are often used interchangeably to conduct the same types of transactions.

The “all-in” alternative which emphasizes account level treatment puts overdraft protection services on the same plane as other types of overdraft protection—e.g., linked deposit accounts, line of credit, or credit card back-up—all of which are applied across the account independent of the payment method used to conduct the transaction. Banks do not, and need not, offer a partial credit line covering only checks or ACH and excluding debit card transactions. The credit line covers all account overdrafts by whatever means incurred. Overdraft programs should therefore be allowed to be on a similar all-in or all-out footing. This is particularly true, as the vast majority of

banks lack the operational capability to allow or disallow debit card transactions on an account basis. As a result, if the Board ultimately decides not to permit the “all-in” alternative, many banks would not be able to offer debit card overdraft services to any of their customers, an outcome that we believe, would be hurtful to many bank customers.

- b) *In addition to allowing an account-wide election of overdraft services, banks should have the option of designing an understandable partial election of overdraft protection services that enables the customer to decline coverage only for ATM and all other debit card transactions.*

In order to provide banks and their customers with optimum flexibility, NYBA believes that a partial option to decline coverage also be permitted in the final rule, in order that banks with the operational capability to offer this service, may have the opportunity to do so. However, if a partial option to decline coverage is permitted, it is imperative that the declination apply to all debit card transactions, not just purchases. The proposal requires banks to allow customers the choice not to have overdraft fees applied to “ATM withdrawals and one-time debit card **transactions**.” [Emphasis added.] In contrast, the model disclosure instructs customers that they may choose to avoid having overdrafts paid on ATM withdrawals and “debit card **purchases** you make at a store, online, or by telephone.” [Emphasis added.] However, “one-time debit card transactions” and “debit card purchases” are not the same.

One-time debit card transactions, for example, include not only purchases, but also bill payments that the customer may individually schedule in advance or arrange at the last minute in order to avoid the consequences of paying late. Many bill payments are increasingly made by debit card, not only as a recurring payment, as the proposal seems to assume, but also as a one-time transaction. However, from a processing stand-point, one-time bill payments are indistinguishable from any other one-time debit card transaction. For example, a customer’s online debit card authorization to pay a store credit card bill is indistinguishable from the customer’s debit card transaction to make an online purchase with that store. Accordingly, from an operational standpoint, it would not be possible to allow customers to choose to have one-time *purchases* declined, but have one-time *bills* paid: the bank cannot distinguish between them. This means that the choice for consumers must be to have *all* one-time debit card transactions paid or declined -- whether the transaction is for purchase or bill pay purposes.

In addition, providing the choice to have recurring payments covered by overdraft services, but one-time transactions declined, is also not feasible operationally as most systems today are unable to differentiate between POS debit card transactions and other types of debit card transactions such

as preauthorized transfers. However, the issue goes beyond “associated reprogramming costs.”

Differentiating among debit card transactions simply cannot be done reliably. A merchant, such as a health club or utility, may obtain a customer’s authorization to submit a debit card transaction each month for bill payment, but the merchant may submit each debit card transaction as a single item – not as a recurring transaction. They may or may not indicate that a transaction is recurring. It is completely beyond the control of the card issuing bank to obtain such information or ensure that such information is accurate. Therefore, the bank would not be able to make a determination to pay or deny a debit card transaction based on whether it is a recurring or one-time transaction. Yet, the banks would potentially be liable for Regulation E violations and subject to class action suits. It would simply be unfair to impose a requirement with which the bank cannot comply and then subject it to liability for not complying.

Whether the final rule does or does not permit banks to condition the choice to decline debit card overdraft services on also declining overdraft services for other payment channels, it must make clear that declining overdraft debit card services applies to **all** debit card transactions, not just purchases, and that consumers understand that it applies to purchases, bill-pay, and other transactions. Beyond the processing reasons that make parsing different types of debit card transactions not feasible, the most important reason is customer confusion. As there are so many variations in how and where debit cards may be used and how they are processed, it would be difficult if not impossible to explain the nuances and variations in a manner customers can clearly understand. However, we think it will be far easier to explain that the phrase “debit card transactions” includes both purchases and bills paid using the debit card or debit card number.

III. The final rule should enable customers to “opt out” of overdraft services.

The Board has proposed two alternative proposed regulations: Alternative One, which would allow consumers to “opt out” of overdraft services and Alternative 2, which would allow consumers to “opt in.” We strongly recommend that the Board adopt the opt-out approach as it more closely aligns with consumer preferences, as confirmed by the Board’s own consumer testing, and provides the bank customer with a backstop for important transactions, in the event that an account has insufficient funds when the consumer authorizes a transaction. Such a scenario, potentially fraught with embarrassment (for example, if a transaction is denied at the grocery store, after the consumer has selected and rung up a shopping cart full of groceries) may not be envisioned at the time of account opening.

Moreover, debit card transactions include bill payments and consumer testing found that consumers want important transactions paid, which would include bill payments made by debit cards. We believe, therefore, that the opt-in approach, in the long run, is likely to create what would otherwise be totally avoidable awkward situations, for customers experiencing insufficient fund situations. As a result customers will be dissatisfied with their banks – an outcome which would also be otherwise totally avoidable.

In the event, however, that the Board does elect to adopt the opt-in approach, the opt-in should be limited to accounts opened going forward. Customers who already have accounts should have the option to opt out, not be required to opt-in for overdraft protection services they already expect and enjoy.

Under proposed Alternative 2 (opt-in), for accounts opened before the effective date, the opt-in notice must be provided on or with the first periodic statement after the effective date or following the first assessment on or after the effective date of any fee for paying an overdraft. For existing customers who have not opted in within 60 days of receiving the opt-in notice, the bank must cease assessing any overdraft fees, in effect, automatically dropping them from overdraft services. However, this does not necessarily represent customers' preferences. Customers who rely and expect overdraft services, whether for ACHs, checks, or debit card transactions, but overlook or do not respond in time to an opt-in notice, may be surprised and extremely irritated when their first payment is returned unpaid and they now face the inconvenient and potentially expensive and embarrassing consequences. Automatically dropping all customers from coverage unless they opt in will cause great customer irritation and inconvenience, provoking a huge volume of complaints. For these reasons, customers with accounts already in existence at the time of the effective date should have the choice to opt-out.

IV. The final rule should include an exception to the prohibition against imposing overdraft fees when a customer has declined overdraft services in cases where the consumer requested the transaction, but the bank did not authorize the transaction.

Our Association appreciates that the Board has recognized a number of exceptions to the prohibition against imposing fees on customers who have declined overdraft services, but strongly recommends that the Board expand the exceptions to other situations that the bank cannot avoid. In particular, we recommend that the Board additionally except from the prohibition against imposing fees on customers who have declined debit card overdraft services, those transactions the bank has not authorized. Otherwise, banks will unfairly have to pay overdrafts that they are unable to stop, without compensation for the risk, and customers will simultaneously be encouraged not to manage their accounts and monitor transactions.

V. Should the Board adopt the proposed prohibition against assessing an overdraft fee if the overdraft would not have occurred but for a hold related to a debit card transaction in which the merchant could determine the amount of the transaction within a “reasonable time,” “reasonable time” should be considered the end of the processing day and the regulation should require merchants to submit transactions by the end of the processing day of the authorization.

Under the proposal, banks may not assess an overdraft fee if the overdraft would not have occurred but for a hold placed on funds in the consumer’s account in connection with a debit card transaction if the actual amount of the transaction can be determined by the merchant within a short period of time after the bank authorizes the transaction. A bank may assess a fee, however, if the bank has procedures and practices in place designed to release a debit hold within a reasonable period of time. Under the proposal, two hours after authorization is considered reasonable.

The two hour timeframe will work for most gas stations because many now will present the actual transaction within two hours. However, restaurants and some gas stations may not be able to submit transactions within that time frame. Some gas stations, particularly small size gas stations, and many restaurants use “batch processing,” which means that the actual amount of the transaction will be submitted later than two hours after authorization, up to three days after the transaction. If the bank must release the hold on the full amount it is obligated to pay the merchant before it knows the final amount, it unfairly risks a loss, which raises safety and soundness concerns. While some banks may choose to release the hold because, at a given time and situation, the risk is manageable, they should have the ability to respond when greater risks are present or change.

We believe that, while many of the merchants lack the capacity to submit the actual transaction amount within two hours, they will be able to do so by the end of the processing day.

VI. The final regulation should provide model language for banks offering customers the option to decline overdraft services for all transactions.

The proposed model forms only apply to situations where the customer has the option to decline overdraft services for “ATM withdrawals and debit card purchases” only. Indeed, the proposed models suggest that other transactions, however, may be paid. “Your decision to opt out will not affect whether we pay overdrafts for other types of transactions including

checks.” This suggests that consumers do not have the option with regard to checks and ACH overdrafts, though we expect that some banks will also give customers the option to have these overdrafts declined. It would be helpful to have model disclosures for these situations to ensure that consumers are not misled and understand their options and to facilitate compliance.

VII. The period to opt out should be shorter and banks should have options on how customers may opt out.

Under proposed Alternative 1, banks must provide an opt-out notice and provide customers a “reasonable opportunity” to opt out. Under the proposed Commentary, a “reasonable opportunity” to opt out is considered 30 days from the date the customer is provided the opt-out notice. We believe that five days is sufficient. Banks report that most people who opt out after receiving a privacy notice opt out within five days at the most. It is natural for people to act immediately or very soon after receiving a notice. It is unlikely that that they will wait 30 days.

In addition, the proposed commentary offers examples of reasonable opportunities to opt out, including by mail, telephone, electronically, or at time of account-opening. The Commentary should be clear that banks are not required to provide all these options and should be able to request verification of the choice in writing. It may not be feasible or efficient for banks - and we believe it is not necessary to consumers - to offer all the options listed.

VIII. The Board should allow at least 12 months for banks to implement the final regulation.

The Board should allow at least 12 months for banks to implement the final regulation. Any final regulation will require more than minor adjustments. After reviewing and analyzing the final regulation and determining how to implement it, banks will have to work with core processors and third party vendors that handle their processing, modify existing software and other systems or install new ones, and test these systems. In addition, banks will have to train employees and educate their customers. Sufficient time is particularly critical for our small bank members who rely on third party vendors.

IX. Conclusion

NYBA appreciates the opportunity to comment on this proposal. We strongly support the Board’s decision to shift the rule into Regulation E. In

addition, to ensure that bank customers continue to have access to valuable overdraft services, we believe that the final rule should accurately reflect how debit cards are used and processed as well as the operational limitations of many financial institutions. We also support allowing customers to opt out of overdraft services and believe that overdraft fees should be permitted when overdrafts are caused by transactions authorized by the consumer, but not approved by the bank. Additionally, should the Board adopt the prohibition against assessing an overdraft fee if the overdraft would not have occurred but for a hold related to a debit card transaction where the merchant may determine the amount of the transaction within a “reasonable time,” “reasonable time” should be considered the end of the processing day and the regulation should require merchants to submit transactions by the end of the processing day of the authorization. Finally, in order to ensure a smooth and effective implementation, we believe the Board should allow for a 12-month implementation period.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael P. Smith". The signature is fluid and cursive, with the first name being the most prominent.

Michael P. Smith