

**From:** "Dalinda Calvetti" <dcalvetti@jeffersonbank.com> on 08/05/2004 05:30:22 PM

**Subject:** Overdraft Protection Programs

August 2, 2004

Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, N.W.  
Washington, DC 20551

Re: Docket No. OP-1198  
Overdraft Protection Guidance

Gentlemen and Ladies:

Jefferson State Bank (the "Bank") is pleased to have this opportunity to comment on the questions raised by the member agencies of the Federal Financial Institutions Examination Council ("FFIEC"); Office of the Comptroller of the Currency, Treasury ("OCC"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); Office of Thrift Supervision, Treasury ("OTS"); and National Credit Union Administration ("NCUA") about potential changes to regulatory guidance regarding overdraft protection services. The above listed agencies have requested comments regarding the proposed Interagency Guidance on Overdraft Protection Programs ("Guidance") published in the Federal Register on June 7, 2004.

The Bank maintains an overdraft management program ("Program") of the general type referred to in the request for comments, although the Bank believes our Program to be significantly more conservative and responsible than some programs. This letter is submitted, as requested by the Agencies, to provide information and comment regarding the proposed Guidance and its implications for overdraft protection programs.

#### DISCUSSION

After an Executive Summary, this letter is divided into five sections, as follows:

Section I:	Background
Section II:	Concerns
Section III:	Safety & Soundness Considerations
Section IV:	Legal Risks
Section V:	Best Practices

#### EXECUTIVE SUMMARY

In the Bank's opinion, the Guidance supplies financial institutions with welcome direction regarding overdraft protection programs. Many financial institutions are meeting and exceeding the recommendations of the Agencies today, and those institutions and vendors who are not should meet the standards set forth in the Guidance. This kind of standardization will certainly be beneficial for consumers and for the financial services industry

as a whole.

As discussed in greater detail below, our Bank's Program was carefully designed neither to grant nor even suggest that the account holder has a right to overdraw his or her checking account. Secondly, as part of our Program, we have modified our written policies for managing credit, operational, and other risks associated with paying NSF's to ensure that these are monitored closely and consistently. Thirdly, our Program already closely follows the Best Practices outlined by the Agencies in the Guidance. As such, we firmly believe our Program meets and exceeds many of the recommendations suggested by the Agencies.

The Bank, however, wishes to voice concern regarding three areas discussed in the Guidance. First, the "Safety & Soundness" section of the Guidance states, "When an institution routinely communicates the available amount of overdraft protection to depositors, these available amounts should be reported as 'unused commitments' in regulatory reports". Most customers never overdraw their accounts, but for operational purposes, financial institutions have found it helpful to automate payment of their NSF's in the event one is presented on the account. According to the Guidance, significant "unused commitments" will need to be defined and reported. In our opinion, reporting the difference between a customer's balance and what an institution will pay for every customer in overdraft as unused commitments is unnecessary and will not have the overall risk management benefit anticipated by the Agencies.

The second remarks in the inter-agency guidelines indicate that overdraft balances should generally be charged off within 30 days from the first date overdrawn. The Bank believes that this flies flatly in the face of existing accounting statements and current requirements. The overdraft, rather, should be written off only after a minimum of 60-120 days to be in conformity to other existing guidelines with regard to problem debt. Again, the Bank program has a system for collection that begins a series of collection letters at 15 days in order to assure that the customer remains on a sound footing. However, requiring an absolute charge-off at 30 days is unnecessary and contrary to current normal practices.

The Guidance also states in the "Legal Risks" section regarding the Truth in Lending Act, "... fees for paying overdraft items currently are not considered finance charges under Regulation Z if the institution has not agreed in writing to pay overdrafts. Since this regulatory exception was created for the occasional ad-hoc payment of overdrafts, its application to these automated and marketed overdraft protection programs could be reevaluated in the future". Charging a fee for presenting an item on an account where insufficient funds exist can never be considered interest because at the time the fee is charged, no decision has been made to pay the item or create a negative balance. Consequently, overdrafts permitted under the Program are not extensions of "credit" under either Regulation B or Regulation Z, making both regulations non-applicable. Efforts to change regulations so that NSF's fall under Reg Z simply because the volume has grown in total or because of the financial imprudence of a limited number of customers does not match the logic and long-defined precedence of fees being charged for the presentment of NSF's. The Bank has concluded that if, in fact, the disclosure and other requirements of Regulation Z are imposed on this very popular service, the cost may render the product ineffective for banks to offer, thereby depriving many customers of important protection. Perhaps most significantly, most of the programs of which we are aware offer the inadvertent overdraft privilege to all customers without requiring the customers to go through an underwriting process. This decreases the cost of providing the service. In addition, it makes the protection available to persons who might otherwise not qualify for open-end consumer credit.

## I. BACKGROUND

The Bank has implemented an overdraft management program known as the Overdraft Privilege Program, which is operated under license from Pinnacle Financial Strategies. We have been using the Overdraft Privilege Program for approximately four months.

As we believe will appear from the discussion below, the Overdraft Privilege Program is a highly responsible approach to automated overdraft management that is made available (but not actively promoted) to the Bank's individual checking account customers. Unlike some of the aggressive "bounce protection" services that have appeared in the industry and raised well-known regulatory concerns, the Overdraft Privilege Program includes a system of straightforward communications to the consumer while providing the Bank with a systematic, centrally managed tool for administering overdrafts, as opposed to the "seat of the pants" approach used at some times in the past.

About the Bank. Jefferson State Bank is a state chartered bank located in San Antonio, Texas with assets of \$537 million. The Bank has nine banking centers and is a locally owned community bank.

## II. CONCERNS

The Guidance states that a chief concern among the Agencies are certain aspects of the marketing, disclosure, implementation of some overdraft protection programs. Specifically, "some institutions have promoted this Overdraft Privilege Program 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". In addition, the Agencies voice concern about the marketing practices adopted by some financial institutions with overdraft protection programs, particularly the ones that appear to encourage customers to overdraw their accounts.

We support the Guidance's recommendation that institutions should carefully examine the risks presented by overdraft protection programs and review their programs to ensure they are responsible, not misleading consumers or encouraging irresponsible fiscal behavior. We are proud to state that our Program does not use any heavy marketing or advertising for exactly these reasons. Furthermore, studies have shown that most people do not present NSF's, nor do they want to - one estimates that nearly 60% of consumers have little or no interest in NSF services. Attempting to promote the Program through spending money on heavy advertising does not make good business sense because the majority of our customers have no desire to use the service. We will continue to adhere to our current disclosure and communication practices as they meet the recommendations of the Guidance.

## III. SAFETY & SOUNDNESS CONSIDERATIONS

The Guidance establishes a clear safety and soundness standard that overdrafts must be charged off within 30 days. The Bank believes this is unnecessary, very consumer-unfriendly, and in contravention of existing regulatory guidance concerning the classification of unsecured consumer debt. The uniform classification of unsecured consumer credit does not suggest a "loss" classification until delinquency reaches 120 days. The OCC Comptroller

handbook on "check credit" similarly lists the same 120 day charge-off requirement for unsecured lines of credit initiated by overdrafts. The Bank suggests a customer-friendly approach that's based on safety and soundness standards requiring prompt notifications to the customer of the overdraft and an encouragement to bring the account to a positive balance as soon as possible. The Bank's Overdraft Privilege Program is discontinued at the 30 day mark with continued customer letters used for further collection. Procedures provide for the charge off of the overdrawn balance at 60 days, at which time additional collection efforts are made.

Based on the experience of the Bank, shortening the charge off period will not result in a greater amount of net quarterly or year-end losses as reconciled by reviewing the ALLL and Provision for Loan Loss accounts. The Bank supports a longer charge off policy than the 30 days proposed and recommends that 60 or 90 days would allow for the reasonable collection of a depositor account while maintaining transparency in the regulatory and financial reporting of the institution. This longer charge off policy is also more favorable to the consumer since no credit damage would be done to depositors by the premature reporting of charged off accounts to the credit bureaus (as is customary when banks charge off an OD as uncollectible).

The guidance provides a new interpretation of reporting requirements for unused loan commitments that would include reporting the total of all potential overdraft approvals under the ODP program as an "unused (loan) commitments." While the guidance is generally otherwise specific that the ODP program must be non-contractual and that the banks right to pay or not to pay an overdraft must continue to be discretionary, the Guidance in this section suggests that even non-contractual programs may be required to report their unused limit on call reports under contractual obligations of unfounded loan commitments.

It appears the authors intend to present the position that an institutional program that "routinely communicates the available amount of overdraft protection to depositors..." could constitute a de facto obligation and an effective binding commitment. The term "routinely communicates" might be further interpreted to be as contained in disclosure materials, in periodic statements, or on ATM receipts. With this language in the Guidance, any "disclosed program" would appear subject to the reporting requirement. The Bank's position is that this reporting requirement should be reserved only for contractually binding obligations such as traditional overdraft lines of credit or other formal credit facilities.

#### IV. LEGAL RISKS

We agree with the caution expressed by the Agencies regarding the legal risks imposed by overdraft protection programs, and we had counsel review our Bank's Program in detail for compliance with applicable state and federal laws prior to implementation.

Regarding each recommendation stated in the Guidance, our comments are as follows:

Federal Trade Commission Act / Advertising Rules.

Our Program provides comprehensive communication to customers through letters, and phone calls. Our policy is to give our customers straight talk and sound advice, as all responsible financial institutions should. Specifically, we state that other alternatives (such as lines of credit and transfers from savings) are available, and encourage customers to contact the Bank to discuss them, if desired.

Truth in Lending Act.

Our Program ensures that all communication and disclosure documents include that the payment of an NSF item into overdrawn status is discretionary, and no written agreement is in place regarding the payment of overdrafts. We establish the same fee for all accounts whether the NSF item is paid or returned, as suggested by the Guidance.

The Guidance does indicate that the application of Reg Z to overdraft protection programs could be reevaluated in the future. We are not in favor of any changes to Reg Z that could prevent the payment of overdrafts as a service to the customer. Credit laws apply when a financial institution extends credit to a consumer. According to Regulation B, the Equal Credit Opportunity Act, "Credit means 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 therefore." The customer does not apply for this service (i.e., they are not an applicant) and a "right" to overdraw is not granted by the financial institution (it is a discretionary activity). Credit laws have not applied to overdrafts in the past, nor should they going forward.

Equal Credit Opportunity Act.

Our Program is designed so that no discrimination exists. Customer accounts are qualified into the Program based upon objective criteria, so the possibility for discrimination is nonexistent. In fact, the automation provided by the Program software reduces the potential discrimination and bias that exists under manual NSF pay/return processes.

Truth in Savings Act.

Our Program does not utilize heavy marketing at all and instead provides sound, prudent advice in every single letter, phone call and email sent to customers on the expense of NSFs and overdrafts. The goal of our Program is to provide a valuable service to our customers, not encourage irresponsible financial management.

Electronic Fund Transfer Act.

Our Program implements payment of NSF items through ATM and POS channels with appropriate reporting on statements, understandable communication, and easy-to-read terminal receipts wherever feasible, and notices at Bank-owned ATMs, as recommended in the Guidance.

## V. BEST PRACTICES

This section contains seventeen bulleted (unnumbered) Best Practices with varying degrees of implied importance. Most of these Best Practices have been previously adopted by the Bank. Of particular concern, the twelfth and thirteenth Best Practice bullets are focused on consumer groups' and regulators' concerns that providing Overdraft Protection Programs at a point of sale terminal and at the ATM has the greatest potential for the imposition of "hidden" fees. With the Bank's data processing systems, a customer may receive funds at an ATM or POS and, because of the timing of the clearing of other checks, the customers electronic transaction may overdraw the account even without an Overdraft Protection Program. We also note that authorizations for debit cards using point of sale terminals may in fact be processed as credit card transactions that may take several days to clear and post resulting in an NSF situation, again, even when no Overdraft Protection Program limit is being considered. The Bank believes the regulators need to be informed that financial institutions clearly do not have complete control in preventing customers from overdrawing their accounts using non-check transactions.

The twelfth Best Practice bullet suggests that a consumer be warned before he can access funds that are known by the institution not to be "the customer's own funds," such as when accessing an Overdraft Protection Program. This section appears to recognize limited availability of bank owned ATMs. The Guidance does not, however, address Point of Sale terminals, most of which are located in retail stores throughout the country. The absences of clear guidance concerning the inability of institutions to provide advance notice to consumers at Point of Sales may create an expectation that institutions should not make Overdraft Privilege available at point of sale locations. In most cases, the ATM and Point of Sale systems are driven by the same balance mechanisms. Clearly, customers want access to their Overdraft Privilege limits at these locations, so regulatory forbearance is needed until technology catches up with new banking products.

The thirteenth Best Practice bullet is clearly meant to address the displayed balances shown during balance inquiries at ATMs and on ATM receipts. It suggests that the only balance that should be displayed is the balance reflecting the "customer's own funds available without the overdraft protection funds included." The bank makes good faith efforts to notify customers by providing notices on their bank owned ATMs, using pre-printed receipts for balance inquiries advising of their limit inclusion, and by providing clear prior disclosures, should be allowed to continue providing Overdraft Privilege at their ATM without undue criticism.

Again, the Bank appreciates this opportunity to provide comment on the Interagency Guidance on Overdraft Protection Programs. We trust this letter has been helpful. If the Board or Staff has any questions, please feel free to contact the undersigned at (210) 736-7660 or [cputnam@jeffersonbank.com](mailto:cputnam@jeffersonbank.com).

Yours very truly,

Carroll A. Putnam

Executive Vice President