From: Gary Propheter [gpropheter@beobank.com]
Sent: Thursday, September 16, 2010 12:01 PM
To: Overdraft Comments
Subject: Comments on the FDIC Proposed Overdraft Payment Program Guidance

I appreciate the opportunity to comment on the proposed guidance for Overdraft Payment Programs. During my 38 years in bank operations I led early efforts at a major institution in the early 1980s to establish a 'pay-all' servicing environment, trading the risk of loss on overdrawn accounts for reduced operating costs and a modest incremental overdraft fees. The program, in a primarily check based payment system, was highly successful and well accepted by consumers and merchants, as its major impact was reducing the number of checks returned by over 80%.

Over the last 20 years payment systems have become increasingly electronic with spectacular debit card growth, accelerated check presentment through Check 21, and the expected migration of paper entries thru same day ACH. This ongoing evolution has turned the overdraft servicing model from a customer service and expense management exercise into a highly profitable income generator which many financial institutions have leveraged, coincidentally creating an entire new industry focused on growing the overdraft business: consulting and software firms vying for who could squeeze most cash out of a bank's customer base. We will see that as the payment system continues to evolve and become more 'instantaneous', overdraft issues undergo additional changes and, I believe, will slowly resolve themselves.

It is easy to say banks took advantage of this recent fee generation opportunity, but the opportunity itself would not have existed if the payments system had not evolved or if customer behavior had not also changed with the payments systems.

The simple fact is overdraft fees are driven by customer behavior, not by bank policies or practices. Statistically, the majority of bank customers have never had an overdraft and a small segment of customers pay a majority of overdraft fees. We at Bank of Eastern Oregon have a good counseling program to deal with overdraft abusers, and I can comfortably say that counseling works, rarely. When counseling fails we have found suspending overdraft limits and turning off debit cards can help, but only slows the problem down. Returning checks and ACH entries doesn't work. These actions reduce customer fees somewhat, but they do not correct the customer's inherent behavioral issue: poor money management practices.

What does work is taking the customer out of the payments system: no checks, no debit cards, no bill pay, and allowing them only a savings account with limited ATM access. But this is not a popular solution to the customer and we eventually are forced to close their account for overdraft abuse, something to avoid as once a customer is out of the banking system its difficult for them to get back in, especially as we report bad debts to agencies such as ChexSystems.

As I see it, to solve the overdraft conundrum legislators, regulators, and banks are faced with three difficult and often contradictory challenges:

The need to move the 'unbanked' population into a banking system from which a significant fraction of the unbanked have been removed due to unsatisfactory handing of their finances
The desire to significantly reduce overdraft fees, either through regulatory fiat, legislative edict, or efforts by banks, which will push marginal customers out into the world of the unbanked. Why? Because banks need financial capacity to offset risk; if overdraft and return fees are not commensurate to risk why would bank's keep a frequent account abuser as a customer?

The need to keep the cost of and access to banking services reasonable for all customers; the counter being banks need to earn enough from fees and deposits to pay for the delivery of services and achieve a market return on their investment in capital, people, systems, and infrastructure.
I suspect the result of legislative and regulatory efforts to manage interchange fees and overdraft fees, irrespective of requirements to modify customer behavior, will reduce the overall profitability of consumer checking accounts, creating many unintended consequences to include moving more marginal accounts into the shadow world of pre-paid cards, check cashing, and payday lending services, where fees in aggregate exceed those in the traditional banking environment.
Today, overdraft and interchange fees subsidize consumer accounts which are otherwise not profitable. Banks, like any business, will find a way to generate a return on capital, either by increasing other revenues or reducing costs, and I expect the end result of these proposals will result in bank's taking a series of risk avoidance and cost cutting measures which will ultimately move operating costs (risk) back to businesses and increase aggregate fees for all customers, thus reducing cost effective access to the banking system for all potential customers.

These well intended, but ultimately flawed, related efforts to regulate consumer fees, design low cost accounts, and other social engineering exercises like CRA, simply miss the entire point of the free market system: when businesses compete, prices go down, quality goes up, and more customers can afford the product. Legislators and regulators need to stop looking through the wrong end of the telescope.

Best regards,

Gary Propheter
EVP & Chief Operations Officer
Bank of Eastern Oregon
PO Box 39
Heppner, OR 97836
gpropheter@beobank.com
541-676-0207