IBC

International Bancshares Corporation

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Federal Deposit Insurance Corporation
OverdraftComments@fdic.gov

The following comments are submitted on behalf of the bank subsidiaries of International Bancshares ("IBC Banks"), a multi-bank financial holding company headquartered in Laredo, Texas with 279 facilities and 443 ATMs serving 107 communities in Texas and Oklahoma. IBC is the largest minority-owned financial holding company in the continental United States with over $11 billion in assets. IBC Banks offer overdraft courtesy to their customers included within a bundled package of free services. We know, based in part on overwhelming satisfaction from our customers and on significant "opt-in" for debit card transactions, that this is a superior product that is highly valued by our customers with enormous benefits to consumers from all walks of life.

We strongly believe the FDIC's proposed guidance on overdraft payment programs is unnecessary and inconsistent with the new regulatory framework for overdraft programs that already affords a strong pro-consumer framework that preserves and promotes the customer's ability to make an informed choice with respect to overdraft coverage. It is imperative that banks and consumers be permitted to assimilate and react to the changes to overdraft programs recently implemented by the Fed before any additional regulatory guidance is proposed. The Fed's recent amendments of Regulations E and DD required significant changes to the business model of overdraft coverage and many operational changes. Until the impact of the sweeping changes to overdraft services has been thoroughly assessed and understood, it would be premature to adopt further regulatory changes to overdraft services.

The FDIC states that the proposed guidance stems, at least in part, from the FDIC's November 2008 Study of Bank Overdraft Programs. In connection with the Study, the FDIC stated that the "study results also will help the banking industry develop more effective overdraft programs to better serve consumers." To the contrary, we believe the FDIC's proposal to enact regulations in the guise of guidance will harm the banking industry's ability to serve consumers because it will effectively destroy the overdraft protection programs that a large percentage of the consumers have opted-in to use, and will dramatically reduce the bank products available to consumers. The FDIC's proposed guidance impairs the ability of banks to continue to offer overdraft protection to millions of customers who have just made their choice and affirmatively "opted in" to receiving the overdraft protection product under the recent Regulation E amendments knowing fully how the product works and its costs. We believe the consumers' right to choose overdraft protection should be respected.

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We further believe the proposed guidance will cause unnecessary confusion and uncertainty regarding overdraft services. This piling on of additional regulatory guidance by the FDIC appears at odds with the recent comprehensive amendments to Regulations E and DD which carefully weighed the value to consumers of overdraft programs and empowered the consumer with an affirmative right to choose overdraft coverage for one-time debit card transactions. The FDIC's lone-ranger proposal appears to overreach by second-guessing the consumer's choice to opt-in to overdraft coverage almost immediately after the opt-in choice was made. The FDIC's proposed guidance establishes arbitrary definitions of "excessive or chronic use" and mandates intervention by the banks when such arbitrary limits are exceeded contrary to the free choice preserved in the Fed's regulatory changes. In the guise of further regulatory guidance, the FDIC's proposal, instead, appears to be *ultra vires* rule-making by the FDIC. Any further supplement to the existing guidelines regarding overdraft services should apply consistently and fairly to all depository institutions and should be in the form of interagency guidance that is agreed upon by all federal banking agencies to avoid unintended consequences after assessing the impact of the recent changes to overdraft services.

A summary of IBC's primary concerns: (1) recent amendments to Regulations E and DD have resulted in significant process improvements at banks like IBC relating to overdraft protection plans, and the FDIC should give banks time to analyze the effectiveness of those improvements before issuing new requirements; (2) the FDIC guidance is inconsistent with these amendments insofar as the guidance limits consumers' rights under the amendments to take advantage of overdraft protection plans that they have affirmatively chosen to use; (3) the requirement that banks contact consumers by phone or in person whenever they use the plan six times in any year is not feasible and hurts both the consumers and the banks (banks' revenues will be reduced putting at risk the retail banking platform, reducing the bundled product offering and services to the consumer as well as future innovation); (4) the check processing order requirements reflect an insufficient understanding of bank processes and consumer preferences; and (5) daily limits are contrary to the structure of the ODC program and will cause gaming.

Before we address in more detail specific proposals in the proposed supervisory guidance, we would like to briefly provide a description of the overdraft courtesy program ("ODC") as implemented by IBC along with some of the business and technology issues that are present in such a program and that are affected by the proposed guidance.

History of overdraft payments. It is important to note that overdraft coverage has always been available in banks in Texas on an ad-hoc basis. From a historical perspective, overdraft decision making occurred every morning with a list of potential overdrafts being prepared and distributed for discussion at officers' meetings. At that time, individual decisions would be made as to which overdraft might be paid. The result was that higher networth customers tended to have their overdrafts covered as the risk on these particular individuals was better understood by the institution and these customers were more likely to be known by officers. Since there was no real way to make a rapid decision on most consumer accounts, almost all (about 90%) of checks were returned, and debit cards were uncommon. With the automation of the overdraft decision, there has been a "democratization" of the process with more customers covered. About 90% of items are now paid rather than returned. This payment process is now possible because a decision can be based on patterns of behavior and repayment history as opposed to personal knowledge of individual customers and because of the scale of the program.

As customers of IBC Banks have increased in number, the likelihood that officers will actually personally know each customer is more remote.

In fact, International Bank of Commerce, headquartered in Laredo, has 367,355 domestic retail customers with 322,764 enrolled in its overdraft courtesy program. Only 97,444 (26.53%) have not chosen to opt-in to debit card transaction coverage, with 66,075 opting out and 31,369 could not be reached. It is no surprise that the overdraft coverage programs are so popular because before those programs were available, insufficient fund items were returned and the consumer wound up paying a fee to the merchant as well as the bank and the outstanding item was not paid. In addition to being embarrassing and expensive, returned and unpaid items damaged the credit record of the consumer and if the unpaid item was a mortgage or other critical payment, the ramifications could be severe. In addition, in Texas writing an NSF check is a criminal offense and comes with severe consequences. Basically, nothing good comes from having a check returned. IBC's ODC program recognizes the importance of paying large critical items by paying items largest to smallest since the largest tends to be the most important.

Fees. As Texas banks, these institutions are bound by the usury laws of Texas and the requirements of the Texas Finance Code. The Texas Supreme Court addressed overdrafts several years ago and concluded that an insufficient funds charge is actually a service fee for the process of determining whether to pay an item. *First Bank v. Tony's Tortilla Factory, Inc.,* 877 S.W.2d 285,288 (Tex. 1994). Therefore, that fee is not interest as defined by Texas law. An overdraft fee which is in addition to the NSF charge or which is higher than the NSF charge would constitute interest under this analysis. Due to the very short term nature of overdrafts, a flat fee will virtually always result in a potential usury claim for a Texas institution. Therefore, Texas banks only charge the NSF fee and do not have a separate and distinct overdraft fee that is higher. Some banks also charge interest on outstanding overdraft balances. This is typically at a rate of 18% per annum. Again, due to the short term nature of the overdraft, the actual amount of interest earned is usually only pennies on an overdraft, and does not support the cost of providing the service, which we believe is recognized under Texas law.

Consumer Open-End Lines of Credit. State law influenced the development of overdraft privilege in another very different way. In 1983, the Texas Legislature revised the usury laws relating to open-end credit accounts so that the interest rate was capped at 14% and all fees were absolutely prohibited. This change applied to both credit cards and consumer revolving credit accounts. As a result, all of the major credit card operations in Texas left the state and moved to more favorable venues. At the same time, consumer open-end credit became virtually unavailable. In fact, the major forms companies providing documents to Texas banks stopped providing the form for consumer open-end credit. The product was simply not available. It is only recently that the laws were changed through an amendment to Chapter 346 of the Texas Finance Code to permit an interest rate of up to 18% on open-end credit with annual fees, a late charge capped at $15, and modest overline and cash advance fees. However, open-end credit is still not generally available at most Texas institutions because the business is not profitable. The overdraft courtesy, while not an explicit line of credit and not guaranteed as available, has filled the void created by the actions of the Texas Legislature. Perhaps, more significantly, this experience demonstrates that when products are restricted to fees that are not economically feasible, the products are eliminated. Banks are not in business to take losses. And the FDIC from a safety and soundness perspective would not look kindly on banks that did not have adequate retained earnings to internally manage capital levels.

Restrictions on the overdraft protection programs in Texas will effectively eliminate credit for many Texas consumers.

Recent regulatory changes affecting credit cards have resulted in a constriction of consumer credit which is exacerbated by the deepening trend of the credit card industry to cut credit lines. [1] This consumer credit crunch does not appear to bode well for the nation's struggling economic recovery and its consumers. Presumably the credit cuts will impact consumers with lower credit scores more severely than higher credit scores.

IBC Program. The overdraft courtesy program offered by IBC Banks permits the banks to bundle a wide array of products and services and provide them at no charge to the customer primarily because of the scale of the program; i.e., a large number of customers. Based on bank data, the cost of delivering the bundled product on average is approximately $462 per account per year. Studies[2] have shown that while historically about half of bank checking accounts were unprofitable, the percentage of unprofitable checking accounts is increasing and we believe the number of unprofitable accounts would skyrocket under the FDIC proposed guidance. Currently, all IBC customers selecting the overdraft courtesy product receive the benefit of the bundled services, which include free checking account with no monthly maintenance or service fees, free on-line bill-pay, free on-line banking, mobile banking, free ATM services, free voice response service, and free debit cards. Our analysis indicates that the average retail value of these products and services is $751. Since initiating this bundled product in 1998 led by the free checking account, IBC's new customers have chosen this bundled overdraft courtesy product over 85% of the time when opening a new account. The bundled package is the overwhelming choice of IBC's new customers for the past ten years. As an example of customer satisfaction with this product, on September 1, 2010, IBC received this message "*I am retired on a pension, and my account is small with only two or three transactions each month. And, my account is a "free checking account" with no service charges, and now I have free bill pay. However your services are valuable to me. What I am trying to get at is that I would feel better if you took a $5 or $10 service charge from my account each month. You have been doing an excellent job for me, and your services have value to me. While this small amount will not make much difference in your overall operations, it is something I would like to do just to say "Thanks for being a good bank.*"" This message is not rare. It is consistent with our experience with many customers.

The free debit card also permits IBC customers, many of whom travel to Mexico, to have inexpensive foreign exchange through the payment system. Many IBC customers live along the Texas-Mexico border. Thus, this is an important additional service.

Perhaps most significantly, the free checking account product has allowed the bank to bring traditional banking services to individuals who are previously unbanked or underbanked. In turn, this allows those new bank customers to avoid the extremely high fees of check cashers and payday lenders and pawn shops.

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[1] See "Whitney: Credit Contracting", Forbes, May 13, 2009. This trend was commented on by the bank analyst Meredith Whitney when she forecast that the credit card companies would cut $2.7 trillion in unused credit card lines by the end of 2010, rather than the $2.0 trillion she originally forecasted.

[2] These studies further reflect that regulatory and business environment changes could hike the percentage of unprofitable accounts to 75 percent. Other research suggests the number of unprofitable and breakeven accounts is much higher – around 90 percent. See Retail Banking Insights, BAI, June 17, 2009.

In addition, the convenience of checks or debit cards for point-of-sale transactions avoid the cost of money orders to pay bills and the insecurity of carrying cash for purchases. Although stored value cards are growing in popularity, they too, have issuance and transaction fees that quickly add up for the unbanked consumer. It should also be understood that all the other products involve travel and time spent acquiring them, which is significant as compared to the convenience of ODC.

We believe the practical implication of the FDIC's proposed guidance would be to essentially destroy the current overdraft protection programs, because the proposed guidance would taint the active programs with the FDIC's implication that they constitute an unfair deceptive trade practice as well as an unsafe and unsound banking practice. Without the scale of the overdraft protection programs, the banks will not be able to afford to offer the wide array of free consumer services. The FDIC's actions will unravel the free bundled offering and result in setting back by decades the advances in consumer bank products; i.e., turning back the clock on retail banking. Unfortunately, the reduction in free bank services is likely to negatively impact the innovation of products, such as mobile banking, that are particularly attractive to underbanked customers. All of the banking products have fixed hard costs, including software and maintenance fees, which must be funded. In recent years, banks have constantly invested in new technology to improve their services and respond to consumers' needs. New electronic services provide new customer conveniences, but they usually do not replace existing services such as branch banking. Further innovation of consumer bank products would be impaired to the extent that the FDIC's proposed guidance negatively impacts the profitability of retail banking.

Additionally, the requirement to contact customers who have more than six overdrafts in a running twelve month period may violate the banks' free speech rights as well as the free market choice of the consumer. Six overdrafts in a twelve month period is a very low level of use. The unreasonableness of the FDIC's low threshold is illustrated by the common practice of consumers to access the overdraft protection in order to bridge their financial gap between pay periods. Even though the consumer made an <u>informed choice to opt-in/opt-out</u> to the bank's overdraft protection program, the FDIC, has unilaterally decided in the guise of addressing safety and soundness issues of the banks, that such a program may be abused by the customer and is too expensive. Compelling the bank to consult with the customer about less costly credit alternatives, which the consumer may or may not qualify to obtain, and making the customer again decide whether to continue with fee-based overdraft coverage may violate the commercial free speech rights of the bank[3] as well as undermine the free market choice of the customer, especially since the customer has already affirmatively opted-in to the overdraft protection program. At IBC alone more than 300,000 consumers have made an affirmative choice to participate in overdraft protection programs during the last several months. They made their informed choice knowing how the product works and its costs, and their choice should be respected, rather than second-guessed.

Despite the claims of the consumer groups who reflect the view of a small percentage of consumers, there are overwhelming numbers of consumers who choose and are satisfied with their overdraft protection program, and have made their choice knowing the costs of the program.

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[3] Compelling the Bank to speak can violate the First Amendment just as restraining speech does so. Commercial free speech was protected by the Supreme Court in *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y., 447* U.S. 557 (1980).

That the FDIC would so limit a product that consumers have so recently opted to take advantage of demonstrates a lack of respect on the part of the FDIC for the consumers' ability to make informed choices for themselves.

Customer Disclosures and Information Resources. The recent amendments to Regulation E have assured that consumers have a clear choice with regard to whether or not their debit card or electronic transaction is subject to overdraft protection. Model debit card disclosures coupled with "Best Practices" suggestions for overdraft programs generally provide consumers with clear explanations of what is and is not covered along with the cost. Furthermore, virtually all banks now offer at least some level of on-line banking and voice response systems.

Thus, customers have easy access to several methods for checking their statements and their balances on a regular basis. Paper statements have forms on the reverse of the statement to facilitate and make easy the reconciliation of the statement for the customer. In short, there are many aids provided to customers to help them keep up with their account balances and thus avoid an overdraft situation, <u>but it is clear that a customer must exercise a certain level of personal responsibility to manage a bank account</u>. That begins with a system to keep up with your bank balance. The most reasonable way to accomplish this is to use the check register provided by the bank.

IBC Banks have engaged in extensive consumer financial literacy programs to assist customers in developing that personal responsibility. Helpful, simple brochures are provided to customers who have demonstrated difficulty in managing their overdrafts. IBC has been recognized by the Texas Bankers Association and the FDIC for these consumer literacy programs.

The FDIC's proposed guidance comes on the heels of the mammoth undertaking by the banks to obtain "opt-in" consent by accountholders before charging fees for covering ATM and one-time debit transactions. IBC spent thousands of employee hours over eight months and enormous sums of money to contact the customers and provide the extensive documentation that had to be developed and deployed in connection with the opt-in/opt-out efforts. The proposed guidance does not allow any time for the positive benefits of the opt-in/opt-out regulatory changes to be measured. The banks and the customers should be afforded a chance to react to and assimilate the changes made to the overdraft protection programs before the FDIC's proposed guidance is considered. The IBC Experience with respect to the opt-in/opt-out efforts underscores how difficult, costly and time-consuming the opt-in/opt-out efforts were. In eight months, IBC reached out to 367,355 customers with the result that 269,911 customers "opted-in," 66,075 customers opted out and 31,369 customers were not able to be reached. In many instances, IBC had to try numerous times and different ways to contact a customer. Even with all these efforts, 31,369 customers never responded. The requirement in the FDIC's proposal that customers who have more than six overdrafts paid in a rolling twelve month period should be consulted about alternate credit products by phone or in person will be very difficult to accomplish, if not impossible, as clearly demonstrated by our opt-in/opt-out effort, as customers will dodge the bank fearing some negative consequence.

Technology Challenges. While technology gives consumers more choices and more ways to manage their accounts, it is also critical to review briefly the advantages and limitations that certain technology provides to the banking system as it deals with different payment systems.

First, it is important to realize that at some ATMs, the participating bank may handle its transactions in a batch mode or in "real time." Also, whether or not transactions can be handled in "real time" will depend on whether the customer is using the bank's proprietary ATM or a foreign one. Transactions will be processed based on the bank's BIN. Currently, there are some limitations with regard to the BIN and how it is recognized at a specific ATM machine. ATMs located in foreign countries offer their own set of challenges as well.

Next, each bank must deal with its own data processor and the software that is available to it in its handling of ATM cards and check cards. The data processor may have the capacity to identify debit card transactions in real time, but some operate in a batch mode. It may or may not have the capacity to provide messages to a bank's proprietary ATM with regard to ledger balances.

The data processor will be reluctant to upgrade its systems to accommodate only FDIC regulated banks, and this is another reason why regulations governing ODC programs should be interagency regulations that apply to all banks. Finally, even if the bank is operating in a "real time" mode, items are only memo posted during the day. Final settlement occurs at the end of the banking day.

Moreover, instances may arise where the data processor is providing "stand-in authorization." This type of authorization occurs when there is a problem in the telecommunications network. For example, if a tropical storm, hurricane, or tornado – events common in Texas and Oklahoma – damages the network, a bank's data processor will stand in for the bank and approve transactions up to a pre-agreed limit. However, because the bank and the data processor cannot communicate, the data processor cannot obtain the account balance to determine whether the customer's transaction will result in an overdraft situation.

Automated teller machines typically have large screens and sophisticated keyboards by which customers can process their transactions. By contrast, check cards are used at point-of-sale in a simple scanner that reads the magnetic strip. The point of sale machine has very little sophistication or capacity to provide information to the customer. In addition, the bank has no control over whether the merchant trains its cashiers to request PIN transactions or signature based transactions. Similarly, the bank has no control over whether the customer elects to handle a check card point-of-sale transaction as though it is a credit card transaction on a signature basis rather than a PIN basis. Finally, some merchants will preauthorize transactions for amounts that do not match the ultimate transaction. Thus, restaurants may add on an estimate for a tip while the customer may leave it in cash or in a different amount. Hotels and rental car companies place significant holds on debit cards anticipating many days of service. Gas pumps may preauthorize for only $1 when the consumer may actually pump $50.

The debit card system is subject to system or network rules as well as the limitations of a variety of data processing systems. When a merchant swipes a card, the transaction is transmitted for preauthorization. The amount of the transaction is compared to the consumer's available funds. If the amount can be covered, then the transaction is preauthorized. At this point, the issuing bank must pay the transaction -- even if the account is later overdrawn. The preauthorized transaction is placed in a "pending" status. Some data processors clear or drop pending items at the end of the business day, whether or not they are actually paid. Typically, the transaction will not post for several days.

Thus, even though the customer may have had adequate funds for the transaction when it was preauthorized, the account balance is now inadequate to cover the full transaction. As noted above, regardless, the bank must pay the item and it is important to note that the fraud trends are increasing.[4]

Finally, customers have a wide array of payment mechanisms today including using paper checks, online bill pay, ACH transactions set up through bill payment services, check cards, ATM transactions including cash disbursal and transfers, mobile banking and other payment mechanisms such as stored value cards. Each of these has a different transaction code and has different implications for data processors. Again, the bank has no control over which mechanism the individual bank customer elects to use at any particular time. However, customers continue to press institutions to provide more choices and more flexibility in handling their payments. It is critical that innovation not be stifled. It is also noteworthy that approximately 82% of IBC Bank overdraft transactions are electronic.

Next, it is important to note that checks are not processed throughout the business day, but rather are batched and processed after the bank's cutoff hour. It would not be immediately feasible to post them in chronological order. Check processing is subject to an array of laws and regulations, including Articles 3 and 4 of the Uniform Commercial Code, Regulation CC-including Check 21, and clearinghouse rules. Specifically, Section 4.303 of the UCC permits a bank to pay items in any order. IBC Banks clearly disclose the order in which items are paid. We have elected to pay largest items first. In addition, we disclose that the posting order may affect the number of NSF charges. However, we believe that our customers prefer to have their mortgage or rent paid first. This consumer preference to have important items paid first, which tend to be large, is confirmed in the Federal Reserve Board's results of consumer testing.[5] The consequences of such a large item rejecting include late fees to the customer, credit damage, embarrassment, return check charges of the bank and merchant, and other legal consequences. Finally, banks are obligated to honor stop payment orders and must also comply with various legal process orders like garnishments, liens and levies.

Consumer Choice. As noted initially in this discussion, the income from overdraft courtesy has allowed IBC Banks to bundle desirable services to customers free of charge. The bank actively advertises its free products. We believe that this is a significant countervailing benefit to consumers. In fact, we would suggest that recent moves by the airline industry to unbundle services (i.e. charging for checked baggage and for refreshments) and the consumer backlash, illustrate this point. Consumers have expressed a preference for bundled services.

Finally, we would point out that the use of technology in making overdraft courtesy more widely available has led to a significant "democratization" of this informal credit. Further, the wide availability of this service has increased scale, and scale has driven down the costs to all customers. Independent third party studies performed for IBC Banks reflect that 88.4% of customers are satisfied or very satisfied with IBC Bank overall.

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[4] During the year ended December 31, 2009 and for the first eight months of 2010, IBC's total losses due to disputes or fraud related to debit card transactions were $797,136 and $887,790, respectively.

[5] See the Federal Reserve Study "Design and Testing of Overdraft Disclosures: Phase Two" dated October 12, 2009, which on page v states "Most participants said that transactions they make by check tend to be larger in size and more important so they want overdrafts for checks to be paid even if it meant being charged a fee."

In addition, 91.1% of customers probably or definitely would recommend IBC Bank. As noted earlier, about 85% of these new customers have selected the bundled free checking with overdraft courtesy as their product of choice. The high level of satisfaction with the bundled free checking product is voiced often by our customers, like the customer whose testimonial we included on page 4.

Economic Framework. Deposits are the primary source of liquidity for funding of bank lending activities. Recent studies have concluded that the cost of opening an account runs between $150 and $200. The IBC data reflects that the retail value of the bundled free checking product per account is approximately $751 per year. The account costs have been offset partially by certain revenue streams, including NSF charges and interchange. Until the Federal Reserve issues rules relating to interchange fee caps, we do not know how much that revenue will be decreased, but we believe the decrease will be significant.

Additionally, we believe the financial impact of the FDIC's proposed guidance would cause severe damage to the retail banking model resulting in a reduction in the number of branch locations as well as products and services. The downsizing has already started as evidenced by the recent announcement by Bank of America that it would offset reform costs through branch closures and layoffs.[6] Logically, the loser will be the consumer as free checking—and bundled products—are re-evaluated. It is also clear that the lost revenue will result in a dramatic downsizing of retail banking, putting the financial viability of retail banking at risk and again harming the consumer. Managing a large number of low-balance accounts is very costly and not a very efficient way to fund loans. The willingness of banks to manage a large number of low-balance accounts will be questionable if the banks are unable to recoup the costs associated with managing those accounts. This is especially true of minority depository institutions that have a large number of low-balance accounts. It is ironic that retail banking is being jeopardized by the proposed guidance of the FDIC that is intended to protect the consumers from over-use or abuse of overdraft protection programs when in fact, <u>consumers have just endorsed those programs by opting-in to the coverage in overwhelming numbers</u>. FDIC is reacting to a very small number of customers who complain, but clearly have a choice not to participate. It is clearly a perverse approach.[7]

The automated overdraft courtesy program works for banks and customers alike because it is offered across the board to a broad spectrum of customers. Thus, the costs of underwriting each customer individually are mitigated, and the vast portfolio of potential users spreads the risk, and creates the scale necessary to cover the costs of the bundled products provided and to absorb the significant ODC account losses that are present with these programs.

Finally, the economic cost to financial institutions comes on top of a barrage of recent regulatory changes, all of which have necessitated technology upgrades, forms changes, training for personnel, and other out-of-pocket costs.

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[6] See "CEOs Offer More Clarity on Revenue Conundrums," American Banker, September 15, 2010.

[7] If, as we believe, the further restrictions on ODC will effectively eliminate free checking and the bundled product offering, it will turn the clock back on retail banking by decades. Reinstituting a charge for services and product platforms will be keenly resisted by consumers and will not work. The consumer has been indoctrinated for over a decade that banking products and services are free. No amount of promotion can overcome that paradigm change.

Not just change, but the pace of change, is creating significant disruption to the operations side of banking. Recent changes to Regulation CC by which all checks are now considered local has increased losses at IBC due to the requirement to make funds available before IBC can actually determine whether the funds are collectible.

The Red Flags for Identity Theft regulations, which were recently finalized not only for banks but for other "creditors," have increased the costs incurred by certain third party vendors utilized by the banks. In turn, these costs are primarily absorbed by the banks or paid by consumers.

An additional hidden cost to our account operations is the continually increasing fraud losses experienced as a result of the application of the unauthorized transaction provisions in Regulation E as expanded by the "zero liability" policies of Visa. Regulation E specifically provides that consumers can be negligent about use of their cards, even to the extent of writing their PIN on the card or its sleeve, and still claim that a transaction is unauthorized. Claims processing is further hampered by the lack of cooperation from merchants and the inability of law enforcement to effectively pursue the majority of wrongdoers with regard to debit card fraud.

In short, IBC and its fellow community banks are experiencing significant additional compliance costs along with significant increased losses in account operations. This proposed guidance would exacerbate that trend, further creating pressure to abandon bundled free checking services.

We would now like to address specific issues raised in the proposed guidance.

Promotion of responsible use. We would suggest that the recent amendments to Regulations DD and E by the Federal Reserve have created the necessary framework for marketing and disclosures. The Federal Reserve carefully preserved consumer choice while at the same time ensuring that disclosures would keep the consumer informed. We are concerned by the potential ambiguity of the term "responsible use" in the FDIC's guidance. Conceptually, this would appear to be reasonable. However, without clear standards, what is "responsible use" could easily vary from examiner to examiner. Further, what actually constitutes "promotion" can vary widely. This particular bullet point also appears to take a swipe at consumers by assuming that they must be protected from their own decision-making. Certainly, marketing materials and disclosures must be clear and not misleading. However, the additional criteria that such items must "promote responsible use" appears patronizing to the public and ambiguous to the bank compliance team. The FDIC approach is formulaic and appears to assume that many consumers have made the wrong choice by opting-in to the coverage. Allowing a federal bank regulator to determine responsible use is clearly contrary to the right of free choice in a free enterprise system. The customer who has chosen to opt-in under the new guidelines, has made that choice clearly understanding the cost of the program, and the customer has complete control of the use of the product. The bank does not cause an overdraft. That decision is a free choice decision of our customers. An action that limits free choice is going far beyond any previous practice and intrudes on freedom of choice and should not be pursued.

Excessive or chronic use. This whole issue would seem moot and appear to now represent regulatory overreach because of the opt-in/opt-out requirement of Reg E.

Now that the customer has made a choice, knowing the cost of the program, why would the FDIC believe as a regulator that they have better judgment than the consumer as to what level of use is deemed chronic or excessive? If a customer wants to use this product to manage their finances, why would the FDIC determine that is an improper, chronic or excessive use? Furthermore, many customers have never believed the use of this product should be confined to occasional or inadvertent use. The FDIC unilaterally suggesting that the broader use of the ODC product by consumers is a practice that needs to be curtailed by the FDIC appears to be regulatory overreach, especially in view of the opt-in/opt-out process now required by Reg E.

This bullet point would require the bank to take certain action if a customer overdraws his or her account and pays a fee on more than six occasions in a rolling twelve-month period. Based on our customer experience, this trigger point is far too low, and should be left as a customer decision, not the FDIC or the bank. Furthermore, because the proposal uses a rolling twelve-month period, it is highly likely that the same customers will be contacted repeatedly, causing ill-will and an enormous cost to the institution.

Currently, IBC provides a series of notices alerting the customer to usage and provides counseling or alternative suggestions when a customer does not restore his or her account to a positive balance within 35 days. This is a fairly common standard among community banks in Texas. At that point, qualified customers are provided a "fresh start" opportunity and counseling on how to manage their account effectively. In addition, IBC provides financial literacy programs regularly and through a variety of offerings which the <u>consumer</u> may select.

The follow-up action in the proposal would include contacting the customer in person or via telephone. There are numerous difficulties raised by this requirement. First, the telephone number may not be current. Many of our customers use cell phones and may change those regularly. We certainly want current phone numbers for our customers, but we have found this to be a challenging task to maintain. The task of managing the phone contact information and then following up with customers through the call center will necessitate the hiring of significant additional staff for the banks adding to the cost of operation, thereby adding more burden on the program pushing it further into the realm of being unsustainable.

Next, we believe that our customers would be offended by this requirement -- assuming that they would respond to a call. Often, customers are concerned that a call from their bank is only bad news -- that they are in collection status. Thus, it is common to find that customers will dodge the banker's call out of anxiety. The required contact from the bank after only six overdrafts is completely contrary to the expectation that the overdraft privilege will be automatic within the limits of the coverage. Each customer chooses how and when they will use the overdraft privilege. Unimpeded access, anytime, anywhere, is perhaps the best feature of the overdraft protection. It is an exceptionally efficient and convenient process for the customer, and completely anonymous.

Customers who are identified at the teller line in our crowded lobbies are not likely to appreciate having their overdraft status identified publicly. Tellers will be discreet, and hopefully the next person in line will not overhear the discussion. However, this will cause a public relations nightmare for the banks, cause delays at the teller line and frustrate everyone. Physical contact with the customer is always very difficult. Customers are extraordinarily concerned with financial privacy and do not like any intrusive practices.

The FDIC is running counter to customer preferences and this will result in negative consequences for the banks. Furthermore, once a customer has been contacted by the bank and counseled, they will resist any further intrusion. Every management team in every bank knows from real world experience that customers will avoid contact when they view that contact as unwarranted or intrusive. Repeated contact with these customers will be near impossible. The prescriptive follow-up requirements in the FDIC's Proposal should be avoided because they essentially constitute government-mandated harassment of bank customers that appears to be predicated on the assumption that consumers need to be protected from their informed choices.

This section also assumes that consumers will either have a savings account that can be linked to their checking or that they can qualify for an open-end line of credit or a small dollar loan. It is our experience that these options are not real ones for our customer base.

IBC has a very active cross-selling program, yet IBC has a large number of overdraft customers who do not have a savings account.[8] A significant number of our retail customers are from South Texas, where the average credit score is 500 or below. The proposed guidance reminds banks of the potential fair lending pitfalls. However, the requirement to offer credit alternatives creates a true trap for the unwary. We assume that our lending policy should consider credit quality and risk in making the decision as to whether or not to extend an open-end line of credit to the customer who is incapable of managing their checking account without overdraft coverage. If we make such loans to customers with credit scores below 500, our safety and soundness is exposed. If we don't make those offers, then apparently the compliance/CRA examiners will criticize us. This is a true "Catch 22" situation for bankers. Any regulatory guidance like the FDIC's Proposal would need to clarify that follow-up communication with customers about alternative products does not constitute unlawful targeting or steering. The provisions of the Equal Credit Opportunity Act and Regulation B prohibit banks from discriminating against an applicant on a prohibited basis in any aspect of a credit transaction. Credit scores have been found to be the only predictive factor of overdraft usage[9] and decisions based on credit scores should not be deemed a prohibited basis when approaching customers about their overdraft experience.

We also know from real world experience that a large number of consumers, many of whom live from pay check to pay check, cannot effectively manage a transfer program whether it be a transfer from a savings account or from a loan product. Some customers simply choose not to manage their checking account and other customers periodically have difficulty finding the time to do so. The bottom line reality is these customers will attempt to operate with a transfer product, but will quickly use up that account and not be able to manage the process, will exhaust the transfer balance and be right back into their overdraft status. Many are more successful managing ODC, but it should also be understood that many fail to adequately manage ODC and the bank suffers large aggregate losses related to the ODC program. If we deny these customers access to ODC, they will be forced to return to the predatory fringe - payday lenders, pawn shops and other undesirable loan sharks.

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[8] Of the 327,865 Free Checking Accounts at IBC, only 49,618 or 15% of those customers have savings accounts at IBC, which demonstrates that a linked savings account is not a viable alternative for the vast majority of IBC customers.

[9] See "Bank Overdraft Fees to total $38.5 Billion" CNNMoney.com, August 8, 2009, which states, in part, "Most people paying these fees have a credit score below 590 or so, Moebs said."

If the proposed guidance is adopted, payday lenders will see an increase in their exploding business. There are already more payday lenders in the United States than McDonalds and Starbucks combined.[10] Although payday lending was almost nonexistent before 1990, each year approximately ten million American households borrow on payday loans.[10] The abuses of payday lending are well documented.

The debt trap is structured so that most borrowers will need to pay high fees to renew loans about every two weeks. Typically, a payday lender holds a check or electronic debit authorization for a week or two (usually until the borrower's next payday). At that time the loan is due in full, but most payday borrowers cannot afford to pay the fees for the loan as well as pay the loan back and still make it to the next payday. But if the check is not covered, the borrower accumulates bounced check fees from the bank and the lender, who can pass the check through the borrower's account repeatedly.[11] Clearly, payday lending is structured to get consumers caught in a vicious cycle of ever-deepening credit. Using a database on payday borrowers of a large Texas-based payday lender, researchers found those approved for a payday loan were 88 % more likely to file for Chapter 13 bankruptcy within two years than the rest of the Texas population.[10] Payday lenders typically operate under a unique business model in Texas whereby their fees and activities are unregulated. The result is that Texas payday loans are the most expensive in the United States and total approximately $2.5 billion annually[12] The practical effect of the proposed guidance is that banks will no longer be able to offer overdraft protection, the popularity of which product has been affirmed nationwide as consumers opted-in to the protection, and many of those same customers will be forced to seek credit from payday lenders, and other unscrupulous providers.

Daily limits. As noted initially in this letter, the current fees do not cover the cost of maintaining consumer accounts.

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[10]Using a database on payday borrowers of a large Texas-based payday lender, researchers find those approved for a payday loan were 88 percent more likely to file for Chapter 13 bankruptcy within two years than the rest of the Texas population. They were also 14 percent more likely to file for Chapter 13 bankruptcy than their peers who had applied – and then been denied – a payday loan. See Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?,* Vanderbilt University Law School and University of Pennsylvania, (September 8, 2008), available at http://bpp.wharton.upenn.edu/tobacman/papers/rd.pdf.

[11] See "Payday Lending: How the Debt Trap Catches Borrowers", at www.responsiblelending.org/payday-lending/tools/resources/debttrap.html

[12] See Don Baylor, "The Hidden Costs of Payday Lending," Texas Business Review (April 2008). The following estimates for Texas payday were set forth in Leslie Parrish and Uriah King, Center for Responsible Lending, "Phantom Demand" (July 9, 2009) based on data from Matt Fellowes & Mia Mabanta, *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential,* Brookings Institution (January 2008) the estimates reflect an average loan size in Texas of $533 compared to the national average of approximately $350:

(A) Total number of storefronts	1,800
(B) Estimated average loan size	$533
(C) Estimated transactions per store	2,296
(D) Estimated storefront loan volume (D=A*B*C)	$2,202,866,101
(E) Online loan volume (Cash America)	$ 449,221,000
(F) Total estimated loan volume (F=D+E)	$2,652,087,101

Placing strict limits on the number of fees charged in one day would simply provide a perverse incentive to some irresponsible customers to overdraw their accounts by writing more checks in a given day since they would not be charged for the over limit items processed. Instead of the daily limit, the limit should be that only an initial fee should be allowed to be charged on each overdraft, which limit is already imposed under the Texas usury laws. This Texas limitation is another reason why the fees related to ODC in Texas are more reasonable than the unregulated payday lenders that keep charging fees over and over again as the same credit is churned. We would suggest that this approach, which prevents a subsequent fee on the same overdraft, is a better approach. If a daily fee is imposed, it should not limit the ability for these programs to be successful. Continuing to strip away revenue sources will kill the scale of the programs and cause their demise.

Check Clearing Procedures. As noted earlier in this letter, checks are cleared in batches at day end. Clearing in order received is not currently feasible.

Also, as noted before, we believe that, as to checks, our customers prefer that the largest items be paid first. The consequences of having a mortgage or rent check bounce or a car payment be rejected are extremely severe. Even under current practices of paying a large percent of the items, banks continue to reject and return approximately 11% of the items presented. The Federal Reserve is studying the payment order issues and any further regulatory guidance regarding this issue should be tabled until after the Federal Reserve has completed its review of these issues. As referenced in Footnote 4, the Federal Reserve's consumer testing finds that consumers want important items, which tend to be large, paid.

Legal Underpinning for this Guidance.
The proposal references the FDIC's 2004 guidance on *Unfair or Deceptive Acts or Practices by State-Chartered Banks* as support for criticism during examinations with regard to overdraft programs. We have noticed formal orders published on the internet by various regulators that criticize banks for their overdraft programs, using Section 5 of the FTC Act (15 USC § 45(a)) as the authority. However, that Act specifically delegates to the Federal Reserve the authority to implement regulations for banks with regard to that section. The Fed has done this through Regulation AA (12 CFR part 227). Indeed, the Fed proposed amendments to Regulation AA relating to overdraft programs in 2008 (Docket No. R-1314). Those amendments were not finalized. Rather, the Fed chose to propose and then finalize amendments to Regulation E to deal with the coverage of debit cards and other occasional electronic transactions in automatic overdraft programs. We would strongly suggest that if banks are to be subject to formal orders and civil money penalties under a UDAP theory, then there should be clear parameters in Regulation AA -- not a "guidance" -- to establish the duties and requirements of banks. It is difficult to understand the UDAP focus on ODC especially now that customers have made a choice to enter these programs fully understanding the cost.

Standards for Unfairness under the FTC Act. As noted above, the FTC Act provides the Federal Reserve Board with responsibility for prescribing regulations defining unfair or deceptive acts or practices. Congress has codified standards developed by the Federal Trade Commission (FTC) in determining which acts are unfair. The FTC has no authority to declare an act or practice unfair unless (1) it causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers themselves; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition.

IBC Banks' experience indicates that the volume of overdraft courtesy accounts has exploded, representing over 85% of consumer accounts; i.e., this is the product of choice for new IBC consumer customers and has been for the better part of the last decade. The number of complaints are statistically insignificant when considered in the context of the total number and dollar balances. With approximately 322,764 domestic retail accounts enrolled in the overdraft courtesy program, for example, 300 complaints in one year would be less than 0.1% of accounts. However, in reality the percentage was even smaller because in 2009, the total number of complaints that IBC received related to the NSF or ODC charges was only .010% of the total number of DDA accounts. Furthermore, during 2010, there have only been 27 complaints relating to NSF or ODC charges reported to IBC by the Department of Banking or the FDIC. As small as these percentages are, IBC has seen an increase in such complaints in recent years and IBC attributes the increase to negative ODC publicity. According to the most recent Texas Department of Banking report to the Texas Finance Commission, there were a total of 1,329 complaints as to all state chartered banks (over 600 banks) in Texas between January 2009 and August 2010.

Of those complaints, 163 were related to NSF fees and overdrafts according to the Texas Department of Banking Director of Strategic Support. This is clearly a very low level of dissatisfaction. Thus, we believe that the "injury" is outweighed by countervailing benefits to consumers.

Perhaps more significantly, however, the "injury" is reasonably avoidable by consumers themselves. With the new "opt-in/opt-out" requirement in Regulation E for debit card and ATM transactions, consumers can elect to avoid having their debit card transactions trigger overdrafts for their account. Then, responsible consumers can and should maintain their check register, review their balances online or by voice response, and avoid overdrafts as a result of their check or ACH transactions. These fees are clearly avoidable by any reasonable standard.

CRA Credit. The guidance concludes that banks will continue to receive favorable CRA consideration for offering positive alternatives to overdrafts for low to moderate income individuals. We believe that our Overdraft Courtesy Program is itself a beneficial alternative in our markets to the other choices that are available in the community. As noted above, unbanked consumers often rely on expensive and inconvenient alternatives like check cashers, payday lenders, pawn shops and the purchase of money orders or use of cash for purchases. Alternatively, they may purchase reloadable stored value cards, which have both issuance and reload fees. By comparison, the bundled free products provided to our customers significantly benefit all our customers – including the low to moderate income sector, the unbanked and the underbanked. By responsibly using a bank account, an IBC customer has convenient access to a very attractive bundle of free products. It is easy to see why many of our under-banked customers use our free mobile banking services -- the customer can access it anywhere, any time without having to travel to the bank.

Macroeconomic Effect. The extremely small limit on number of overdrafts before an account is considered to have excessive dependence on overdrafts and the emphasis on offering alternatives that simply are not feasible (or reasonably available to many users) could lead a skeptic to believe that the ultimate objective of this proposed guidance is to eliminate this product. As noted throughout this comment, customers have indicated their preference for overdraft protection and have not opted out of coverage.

Few complaints are registered, either at the bank or with its state/FDIC regulator. However, the income generated from the program allows the bank to offer valuable services and products to its customers. The retail deposits then fund much of the banks' lending operations. Without a reasonable level of NSF charges, the community banking industry's capacity will be severely restricted.[13] Retained earnings, an important component of capital, will shrink. The ripple effect on credit must not be ignored in the quest to craft cookie cutter retail products in Washington. Ultimately, this guidance will stifle the ability of many banks to offer new creative products and will disadvantage a vibrant community banking industry. It will also remove choice from the consumer and place it with the federal government. That is a very poor decision.

If this product is eliminated, significant damage to the community banking system will occur, causing employee losses, branch closings, and the loss of innovation in the retail banking sector. In the end, the customer will be thrown to the wolves – the payday lenders, pawn shops, check cashers and other nefarious parasites of short term credit.

Conclusion. We strongly believe the FDIC's proposed guidance on overdraft payment programs is unnecessary and inconsistent with the new regulatory framework for overdraft programs that already affords a strong pro-consumer framework that preserves and promotes the customer's ability to make an informed choice with respect to overdraft coverage. The right of the consumer to choose overdraft protection must be respected.

It is imperative that banks and consumers be permitted to assimilate and react to the changes to overdraft programs recently implemented before any additional regulatory guidance is proposed. We strongly believe that the recent amendments to Regulations E and DD should be given a chance to take effect. If a review of the experience of banks and customers alike still shows possible concerns, then the Federal Reserve should exercise its statutory authority to amend Regulation AA to provide clear guidance for banks. The FDIC's proposed guidance would disadvantage banks supervised by the FDIC, because the proposed guidance would not apply to banks supervised by the other regulators. This aggressive action by the FDIC is unwise, ill-conceived, and unwarranted and represents a gross intrusion into the free market economy.

Furthermore, we believe the check clearing procedures in the proposed guidance would impermissibly preempt state law (UCC) under the new Dodd-Frank Act standard and are simply out of touch with real-world processes.

Thank you for this opportunity to comment.

Respectfully submitted,

Dennis E. Nixon
President

[13] It is clear that the banking industry does not cover all costs of providing retail banking services to the public. A simple look at the non-interest expense or efficiency ratios of any bank will show that each bank must rely on non-interest income to produce a profit. If the FDIC imposes significant restrictions on the banks' revenue stream by curtailing NSF income, many banks will perish or at a minimum be forced to massively restructure by eliminating many retail products and services causing significant reductions in staff and facilities with loss of services to consumers.