

First State Bank  
P.O. Box 778 – 406 West Grand Ave.  
Yoakum, TX 77995  
361-293-3572

September 27, 2010

Ladies and Gentlemen:

Our Bank is First State Bank, Yoakum, Texas, and a \$126 million dollar bank. We offer an overdraft protection program that is automated and we still honor overdrafts on an unplanned basis.

The FDIC's proposed guidance on overdraft payment programs and consumer protection will significantly affect our bank. This in turn will eliminate a product that is desired by our customers and which provides a stable source of fee income that supports free checking and other products of significant benefit to our customers.

Regulation E was recently changed to require consumers to opt in to debit card coverage. We strongly believe that this process should be given time to work. It is simply premature to add on to the regulatory burden for overdraft programs.

We have historically made overdraft coverage available—but on an ad-hoc basis. Before automation, every morning a list of potential overdrafts would be prepared and distributed for discussion at officers' meetings. Then, individual decisions would be made as to which overdraft might be paid. The result was that higher net worth 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. As a result, most 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, but we continue to daily sort and review the overdraft list by loan officer. Now, more items are paid rather than returned.

The recent amendments to Regulation E have assured that consumers have a clear choice with regard to whether or not their occasional 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 our bank offers on-line banking and a voice response system. Thus, our 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 our customer. In short, there are many aids provided to our customers to help them keep up with their account balances and thus avoid an overdraft situation.

This guidance would appear to require our bank to become extremely paternalistic and provide additional assistance to our customers, either individually or through classes, to counsel them on how to manage personal finances. Our concern is the paternalistic tying of education to our customers' usage of overdraft protection.

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 our customer is using our bank's proprietary ATM or a foreign one. Transactions will be processed based on our bank's BIN. Currently, there are some limitations with regard to the BIN and how

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it is recognized at a specific ATM machine. ATMs located in foreign countries offer their own set of challenges as well.

Next, our 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. We operate in a batch mode with our data processor. Final settlement occurs at the end of the banking day.

Moreover, instances may arise where our 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 – damages the network, our bank's data processor will stand in for our bank and approve transactions up to a pre-agreed limit. However, because our bank and our data processor cannot communicate, our data processor cannot obtain the account balance to determine whether our customer's transaction will result in an overdraft situation.

Automated teller machines have large screens typically 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 stripe. The point of sale machine has very little sophistication or capacity to provide information to our customer. In addition, our bank has no control over whether the merchant trains its cashiers to request PIN transactions or signature-based transactions. Similarly, our bank has no control over whether our 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 our customer may leave it in cash or in a different amount. Hotels and rental car companies place significant holds on debit cards. 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, our bank must pay the transaction even if the account is later overdrawn. The preauthorized transaction is placed in a pending status. Some data processing clears or drops pending items at the end of the business day, whether or not they have actually paid. Typically, the transaction will not post for several days. Thus, even though our 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, our bank must pay the item.

Finally, our 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 disbursement and transfers, and other payment mechanisms. Each of these has a different transaction code and has different implications for data processors. Again, our bank has no control over which mechanism our individual bank customer elects to use at any particular time. However, our customers continue to press our bank to provide more choices and more flexibility in handling their payments. It is critical that innovation not be stifled.

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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.

Our bank has been processing in the following clearing order for approximately ten plus years:

- Deposits are posted first
- Items with no check number are posted in smallest to largest denominations
- Checks are then posted in check number order (smallest number to highest number, we feel customers write in check number order)

Deposits are the primary (but not only) 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. In addition, each account costs typically about \$300 per year just to maintain. These costs have been offset partially by certain revenue streams, including NSF charges and interchange. Accounts with average overdraft fees are not even breaking even at this time. Until the Federal Reserve issues rules relating to interchange fee caps, we do not know how much that revenue will be decreased.

The automated overdraft courtesy program works for our bank and our customers alike because it is offered across the board to a broad spectrum of customers. Thus, the cost of underwriting each customer individually is eliminated, and the broad portfolio of potential users spreads the risk.

The recent amendments to Regulations DD and E by the Federal Reserve have created the necessary framework for marketing and disclosures. However, we are concerned by the potential ambiguity of the term responsible use. 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 requirement that programs must promote responsible use appears patronizing to the public and ambiguous to our bank's compliance team.

The point of excessive or chronic use would require our 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. This trigger point is far too low. It appears to be taken from recent proposed overdraft legislation that has not been approved by Congress. 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 our bank.

The follow up action in the proposal would include contacting our 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 some change those regularly. The

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task of managing the phone contact information and then following up with customers through calls will necessitate the hiring of additional staff for our bank.

Our bank would be required to contact our customers by phone or in person to counsel them about their poor financial management practices! Nine percent of our overdraft privilege customers are in overdraft more than six times per year. Our loan officers already deal one on one with the customer when there appears to be a direct abuse of the overdraft program. We also teach financial literacy programs at the local schools in our communities.

Next, we believe that our customers would be offended by this requirement—assuming that they would respond to a call. Often, our 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 our customers will dodge our bank's call out of anxiety.

Our 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 only the next person in line will overhear the discussion. However, this will cause a public relations nightmare for our bank.

This section also assumes that customers 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. This option of automatic transfer from savings to checking is typically offered up front when consumers open up their account. Many of our typical overdraft customers will not have savings accounts (or will exhaust them quickly). In addition, an automatic sweep from savings into checking is subject to the limitations in Regulation D so that no more than six transactions can be made per month. Further, there is no guarantee that our overdraft users will qualify for a loan.

The proposed guidance reminds our bank of the potential fair lending pitfalls. However, the requirement to offer credit alternatives creates a true trap for the unwary. Lending policies should consider credit quality and risk in making the decision as to whether or not to extend credit to a customer who is incapable of managing their checking account without overdraft coverage. If we make such loans to our customers with poor credit, surely safety and soundness examiners will criticize the practice. However, if our bank doesn't make those offers, then apparently the compliance/CRA examiners will criticize us. This is a true Catch 22 situation for our bank.

In short, this proposal will significantly add to the cost of our overdraft program through increased labor expenses, embarrass and annoy our customers, and ultimately achieve very little.

Currently, when our customers are not able to restore their accounts to positive balance, we will provide our customer a chance to pay the overdraft over a period of time and counseling on how to manage their account effectively. We would suggest that the better test for excessive use is the failure of our customer to restore his or her account to a positive status. Further, the offer of a payout opportunity is a better alternative than the options suggested in the guidance.

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With the strict limitations in Texas law, the current fees do not always cover the cost of maintaining consumer accounts.. Also, this creates disparate regulatory requirements depending on whether or not an institution is a nonmember bank subject to FDIC examination.

The proposal would appear to require daily caps on overdraft fees while the Best Practices only suggested this. We have a daily cap of \$100.00 and have had it since August 2006. We feel this level is adequate and uses common sense.

In the discussion of Regulation E requirements, the proposal appears to make the assumption that we as a bank have done a good job of educating our customers about their overdraft options and which a significant number of customers opted in to debit card coverage and we must have impermissibly steered our customers. We believe that if we have provided the model notice to our customers and our customers have elected overdraft coverage, then it is simply wrong for the FDIC to find that our customers were steered into such product. The disclosures clearly identify alternative products for consumer consideration.

Surely the FDIC is not suggesting that the Fed's model form does not adequately disclose critical information to the consumer? This section of the guidance should focus on whether banks have complied with Regulation E rather than veer off into hazy fair lending assumptions that are patronizing to the public.

In conclusion, 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 our bank and our customers alike still show possible abuses, then the Federal Reserve should exercise its statutory authority to amend Regulation AA to provide clear guidance for our bank.

However, if this guidance is adopted, we urge the substitution of a repayment option approach to our customers who do not bring their accounts current rather than the approach of contacting our customers when they overdraw their accounts more than six times in a rolling twelve-month period.

Further, the check clearing procedures as mentioned above that we have at our bank is justifiable and uses common sense.

Finally, we would hope that as the insurer of our bank the FDIC would seriously consider the economic implications of this proposal on the current banking system in the United States. The tenor of the guidance and the unrealistic assumptions made in it make it appear that the objective is to destroy overdraft protection programs rather than to assist banks in offering them in a responsible manner. Thus, we recommend a withdrawal of this proposal.

Thank you for this opportunity to comment.

Sincerely,  
Emily Drozd  
SVP, Cashier and Compliance Officer

/ed