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ATTORNEYS

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Federal Deposit Insurance Corporation
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Re: FIL-47-2010

As outside bank regulatory counsel, our law firm represents over 100 banks domiciled in Texas. Our clients range from very small independent banks to some of the largest community banks in the state. Almost all of our bank clients offer overdraft protection programs for their customers, and many of them are FDIC-regulated banks that will be affected by the proposed guidance. We have assisted many of these clients with their compliance issues as it relates to overdraft protection including implementation of the recent changes to Regulation E and the disclosure and marketing requirements in Regulation DD. Therefore, we would offer the following comments for your consideration. The various trade associations and individual banks can provide insights as to the practical issues relating to the overdraft guidance. We would like to identify several legal areas of concern. To summarize, our legal concerns are as follows: (1) that the guidance appears to constitute *ultra vires* rule-making due to the failure to follow formal rulemaking procedures; (2) that the guidance invites unreasonable allegations of steering violations; (3) that the guidance appears to overreach and be an end run around the Federal Reserve's UDAP rulemaking authority; (4) that the guidance appears to violate the commercial free speech rights of banks as well as the free market choice of the consumer; (5) that the guidance attempts to impermissibly preempt Texas state law (UCC); and (6) that the guidance is contrary to the recent amendments of Regulations E and DD and would unfairly disadvantage banks supervised by the FDIC.

Due to these legal concerns, we urge the FDIC to withdraw the supervisory guidance. If the FDIC does not withdraw the supervisory guidance, we urge the FDIC to delay implementation of the guidance due to the Fed's recent, extensive changes to overdraft services regulation. The FDIC proposed guidance exacerbates the uncertainty in the marketplace and within the regulatory agencies regarding overdraft services, this is especially true in view of the recent creation of the Bureau of Consumer Financial Protection. At a minimum, we urge the FDIC to revise the proposed guidance to address the legal concerns set forth in this letter.

Our primary concern is that this proposal appears to be an attempt to circumvent the rulemaking process by issuing a "guidance" yet giving that guidance the force of law. We encourage the FDIC to clarify whether it intends to treat the guidance as rules that must be followed. If the FDIC does intend to treat the guidelines as rules, the FDIC is not following the appropriate process. It is a well-established legal principle that only legislative rules that are created through the formal rulemaking procedures have the force of law. The FDIC is attempting to treat the informal guidance as a legislative rule, but the FDIC is not following the appropriate rule-making procedures. Accordingly, the guidance should not have the force of law. *See Chrysler Corp. v. Brown*, 441 U.S. 281, 302-303, 315 (1979) (holding nonlegislative rules do not have the force of law.) The guidance states, in part, "to mitigate safety and soundness and compliance risks, and avoid violations of related laws and regulations, the FDIC expects its supervised institutions to

take the following actions regarding automated overdraft payment programs." Through this approach, the FDIC effectively is ensuring that the guidance will have the force of law, without following the formal rulemaking procedures for the guidance.

Evidently, the FDIC is relying on its ability to enforce UDAP regulations with respect to the guidance, but the guidance goes far beyond the existing UDAP regulations related to overdraft services. We are aware of public enforcement actions that impose civil money penalties for violations of the "unfair or deceptive acts or practices" (UDAP) section of the FTC Act with regard to overdraft programs. It appears that the FDIC is relying on the FTC's definitional and legislative history to determine what constitutes an unfair or deceptive act or practice rather than proposing a standard through the notice/comment rule making procedure. This is problematic for several reasons. First, it does not allow for the fullest and best input from the regulated institutions as would be true for a regulation. Second, it does not provide the clearest framework to affected banks for compliance.

As is the case with the original joint guidance, the proposed guidance emphasizes that steering or targeting consumers on a prohibited basis for overdraft programs will raise fair lending concerns under the Equal Credit Opportunity Act. The unilateral emphasis of the steering issues by the FDIC is troubling because both UDAP and Fair Lending findings in a compliance exam have extremely severe consequences for an institution. Is the FDIC trying to alert banks regulated by the FDIC that they will be held to a higher standard with respect to the steering issues? It has been our recent experience that a UDAP finding or a steering conclusion will result in an automatic downgrade of the bank's compliance rating. Furthermore, in the case of a steering violation there is typically an automatic downgrade of the CRA rating. These examination results then have a cascading negative effect as a downgrade in rating may trigger more frequent examinations and possibly a Memorandum of Understanding or other enforcement action as well as civil money penalties. A less than satisfactory CRA rating prevents an institution from branching, engaging in a merger or other acquisition, qualifying for public fund deposits (in Texas), becoming disqualified for long-term federal home loan bank advances, and a host of other significant consequences including reputation costs. Thus, any regulatory pronouncement with such significant consequences should be clear, adopted through the Administrative Procedures Act as a rule, and provide the sort of definitive guidance that will assist an institution in appropriate compliance. This proposed supervisory guidance does not meet those standards in our opinion.

Furthermore, the use of UDAP as the source of authority for the guidance appears to be an end run around the clear rulemaking authority delegated to the Federal Reserve in the FTC Act itself (15 USC §45(a)). Certainly the FDIC has authority to enforce the UDAP regulations. However, we believe that the proposed guidance itself is intended to be treated as a legislative UDAP rule that is not supported by the statutory authority delegated to the FDIC.

Next, assuming that this guidance is not *ultra vires* rule-making, but the FDIC's enforcement of existing UDAP regulations, we believe that the guidance is not in fact supported by UDAP. In the FDIC's 2004 Guidance on Unfair or Deceptive Acts or Practices by State Chartered Banks (FIL-26-2004), the standards for determining what is unfair or deceptive is spelled out:

> An act or practice may be found to be unfair where it "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." A representation, omission, or practice is deceptive if it is likely to mislead a consumer acting reasonably under the circumstances and is likely to affect a consumer's conduct or decision regarding a product or service.

However, in the case of overdraft protection programs, which are conducted in compliance with Regulations E and DD, we believe that the tests for an unfair or deceptive act simply cannot be met. First, Regulation DD provides clear requirements for the disclosure and marketing of overdraft programs. Second, Regulation E provides model forms and procedures to educate consumers and allow them to make a choice to opt-in to coverage of debit card transactions. And finally, any theoretical harm to the consumer is outweighed by the countervailing benefits to them of readily available protection for their inadvertent overdrafts.

We are also concerned by the requirement that state non-member banks subject to the guidance contact customers to admonish them about their chronic usage and educate them about alternatives other than the overdraft product offered by the bank. This requirement coupled with the suggestion that the banks should educate consumers about free or low cost financial education workshops or individualized counseling appears to violate the First Amendment's protection from compelled speech. If the FDIC does not revoke the proposed guidance, we strongly urge the FDIC to revise the guidance to eliminate any concern that it could be interpreted as compelling any speech or any particular speech. 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). Laws that compel speech pose the inherent risk that the government seeks "not to advance a legitimate regulatory goal, but to suppress unpopular ideas or information or manipulate the public debate through coercion rather than persuasion and are subject to rigorous scrutiny." *Simon and Schuster Inc. v. Members of the New York State Crimes Bd*, 502 US 105, 116 (1991).

To decide whether the government has violated a person's First Amendment rights, courts must first determine whether a particular regulation is content based or content neutral. Content based regulations that compel speakers to utter or distribute speech must meet a strict scrutiny test. In order to pass a First Amendment muster the government must show that the regulation is necessary to serve a compelling state interest and is narrowly drawn to achieve that end. Content neutral regulations will be sustained if they meet an intermediate scrutiny test. In the case of this guidance, we believe that the requirements identified above constitute content based compelled speech and thus violate banks' First Amendment rights.

Furthermore, the compelled speech is simply premature and unnecessary. The Federal Reserve has recently amended Regulation E to require banks to provide a model notice with specified items of information about a bank's overdraft protection program and then provide consumers with the opportunity to decide for themselves whether they wish to opt-in to overdraft protection for everyday debit card transactions. This rule became effective August 15 for existing accounts. Millions of bank customers have recently made the informed decision to opt-in to overdraft coverage and their decision should be respected. We strongly believe that the

approach of providing adequate information to consumers and then allowing them to make an informed choice is a better approach and should be allowed to work. For these reasons, we believe the guidance violates the commercial free speech rights of the banks as well as the free informed market choice of the consumers.

In addition to the changes to Regulation E, the Federal Reserve amended Regulation DD only a short period ago. The amendments to that disclosure rule require information at account opening as well as information in periodic statements about overdraft fees. The periodic statement must report the total dollar amount of NSF fees for the statement period and the calendar year-to-date, using a specified format. (12 CFR §230.11) The informed consumer can readily determine the costs of overdraft protection and thus make better—or at least informed--decisions. If the cost is excessive as reflected on the periodic statement, then the consumer may make a different choice. However, if the benefit of the program outweighs the cost to the consumer in his or her opinion, then the consumer should make that decision, not a federal banking agency.

The proposed supervisory guidance also would require changes in check clearing procedures to "include clearing items in the order received or by check number." If the FDIC does not revoke the proposed guidance, the FDIC should clarify that it is not requiring banks to post in a particular order because to do so would raise a serious preemption issue. Texas law permits banks to post items in any order. (§ 4.303 Texas Business & Commerce Code) This section, which is a part of the Uniform Commercial Code, provides the current state law framework for posting items. Most recently, it was reviewed by the Houston Court of Appeals in *Fetter v. Wells Fargo Bank Texas, N.A.*, 110 S. W. 3d 683 (Tex. App.—Houston [14th Dist.] 2003, no pet.). In that case, the court concluded that the law means exactly what it says, that this has been the law for three decades, and that Wells Fargo could post in any order. The Court actually reviewed a "legislative comment" which indicated that the posting order should not maximize fees to the Bank. In reviewing the legislative history, the court concluded that the comment from the State Bar Committee was not itself law and did not affect the decision.

We also believe that this clear state law should not be preempted indirectly by a mere supervisory guidance. More particularly, the recently enacted Dodd Frank Act would appear to stand in the way of such preemption through application of the Barnett Test. (Section 1044 of the Dodd-Frank Act) The Texas statute that would be preempted does not significantly impair or prevent the operation of banking. Certainly, it is not appropriate to preempt long standing uniform commercial law through a guidance.

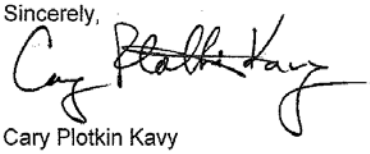
The guidance also indicates that the banks should not steer or target consumers on a prohibited basis while offering other consumers overdraft lines of credit or more favorable credit products. While admittedly this is a part of the original joint guidance, the bold emphasis on the steering topic in the guidance being unilaterally proposed by the FDIC is extremely concerning. The broad reference to steering is of concern given the difficulties of defending an institution from a disparate impact allegation based on statistical analyses.

Finally, we strongly urge the FDIC to simply delay this guidance and withdraw it at this time. We believe the guidance is contrary to the recent changes to Regulations E and DD and would

unfairly disadvantage the FDIC-regulated banks. The timing of this proposal is suspect and raises the question of why the FDIC is proposing this guidance so soon after the banks have struggled to implement the changes in Regulations E and DD and before the new Bureau of Consumer Financial Protection is up and running. Clearly the Bureau of Consumer Financial Protection has authority to issue rules relating to overdraft protection and unfair, deceptive or abusive acts or practices. Acting unilaterally now before the Bureau is in place appears to be an end run around the new Bureau's authority.

For all of these reasons, we strongly urge you to withdraw the supervisory guidance.

Sincerely,



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