

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 81-12
January 15, 1981

AMENDMENT TO REGULATION E

TO ALL MEMBER BANKS AND
OTHERS CONCERNED IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Board of Governors of the Federal Reserve System has amended its Regulation E, which implements the Electronic Fund Transfer Act. The amendment permits creditors to debit their customers' accounts automatically for repayment of preauthorized overdraft credit. Effective date of the amendment is January 15, 1981.

Enclosed is a copy of the Board's material submitted for publication in the Federal Register. These pages more fully explain the Board's action. Any questions regarding the amendment should be directed to the Consumer Affairs Section of our Bank Supervision and Regulations Department, Ext. 6171.

Sincerely yours,

William H. Wallace

First Vice President

Enclosure

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FEDERAL RESERVE SYSTEM

[12 CFR Part 205]

[Regulation E; Docket No. R-0326]

ELECTRONIC FUND TRANSFERS

Exemptions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is adopting in final form an amendment to Regulation E, which implements the Electronic Fund Transfer Act. The amendment, which was published for comment in proposed form on October 6, 1980 (45 FR 66348), exempts overdraft credit plans from § 913(1) of the act. That section prohibits a creditor from conditioning an extension of credit on repayment by means of preauthorized debits. The amendment creates an exception for overdraft credit plans, which have historically included an automatic payment feature.

EFFECTIVE DATE: January 15, 1981.

FOR FURTHER INFORMATION: Regarding the regulation, contact John C. Wood, Senior Attorney, or Beth Morgan, Staff Attorney, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D. C. 20551 (202-452-2412). Regarding the economic impact analysis, contact: Frederick J. Schroeder, Economist, Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, D. C. 20551 (202-452-2584).

SUPPLEMENTARY INFORMATION: (1) General. Under § 205.3(d) of Regulation E, which implements the Electronic Fund Transfer Act, certain electronic fund transfers that are intra-institutional and that have been preauthorized by the consumer to occur automatically are exempt from the requirements of the act and regulation. This exemption applies to loan payments made from the consumer's account to the financial institution; the financial institution remains subject, however, to § 913(1) of the act -- the "compulsory use" provision. That provision prohibits the conditioning of an extension of credit on the borrower's repayment of the credit by preauthorized electronic fund transfers.

On October 6, 1980, the Board proposed an amendment to the regulation that would create an exception with respect to overdraft credit plans. Under such plans an automatic advance from the financial institution to the consumer's account will occur when the consumer's account is overdrawn. Reciprocally, the plans almost universally have provided for the automatic debiting of a minimum payment during a cycle in which a credit balance is owed by the consumer.

(2) Comments on proposal. The Board received approximately 140 comments. All but two supported adoption of the proposed amendment.

A Congressman commented that the impact of permitting preauthorized debits pursuant to an overdraft checking plan is not unduly onerous on consumers. However, he believes that the act unambiguously forbids such a requirement, and that the Board lacks the statutory authority to implement the change. If there is compelling need for such a change, he believes the appropriate course would be for the Board to recommend that the Congress amend the law so that overdraft checking plans are exempt.

The comments in support of the proposal noted some of the benefits that accrue to consumers from overdraft checking plans generally. These include a reduction in charges paid by consumers for returned items or for overdrafts, the ability to obtain credit as it is needed and in smaller increments than might otherwise be available from the institution, and protection against the inconvenience and embarrassment of having items returned for insufficient funds.

With regard to the automatic payment feature, the commenters believe that consumers benefit from the convenience of having minimum payments made automatically, from reduced finance charges since payments are always made on the due dates, and from the absence of late payment charges that characterize many non-automatic payment systems. They assert that under a non-automatic system, delinquencies are generally higher if for no other reason than that consumers forget to mail payments. This is likely to occur in cases where consumers are accustomed to having payments take place automatically.

Commenters believe a requirement that financial institutions provide an option for non-automatic payment (if the amendment were not adopted) could lead to the termination of overdraft service, particularly in cases where the added expense of maintaining a dual payment system of automatic and external payments means that the overdraft service cannot be cost-justified. In other cases, again because of cost justification, overdraft service could become unavailable to consumers who now qualify for relatively small credit lines.

Commenters noted that financial institutions benefit from automatic debiting because automatic payments minimize delinquencies, collection costs, and time spent in processing check payments. Providing a different payment option, on the other hand, means setting up a billing program, printing coupons or other payment reminders, special encoding, processing of additional paperwork, and increased collection efforts.

Some institutions reported that they had already implemented a non-automatic payment option. They find that processing of non-automatic payments is time consuming if done manually, yet expensive to do by computer. These institutions strongly support the amendment because they find that few customers are opting for non-automatic payments, the institution would need to expend additional thousands of dollars to make the dual payment system more efficient, and operation of a non-automatic payment option means continuing costs for them. One bank modified its overdraft plan at a cost estimated between \$4,000 and \$12,000, and has yet to have a customer request the non-automated means of payment.

(3) Economic impact. Overdraft protection is a service that financial institutions have been providing to consumers at little or no extra cost beyond the cost of the protected account. The cost has been low in part because the service is highly automated. The financial institution's computer keeps track of the consumer's balance and credit limit, automatically advancing funds to cover any overdrafts. The computer also automatically debits the consumer's account according to a prearranged schedule to repay the loan.

Under § 904 of the act, setting forth the Board's authority to prescribe regulations, the Board is directed to consider the cost and benefits to consumers and financial institutions and, to the extent practicable, to demonstrate that the consumer protections provided by the regulations outweigh the compliance costs imposed on consumers and financial institutions.

The Board believes that the cost of providing and maintaining a non-automatic payment option is substantial and that it could have an adverse impact on consumers. There is general agreement that the cost could lead to higher service charges or reduced service levels for consumers. In some cases, it could lead to the termination of the overdraft service altogether -- to the detriment of consumers. In others, the service could become unavailable to consumers who now qualify for overdraft checking but who might not qualify if an institution adopted stricter standards or set higher minimums for overdraft credit lines.

(4) Regulatory provision. After careful consideration of the issues raised, the Board is adopting the amendment as proposed. The Board believes that it has the legal authority to adopt this exception under § 904(c) of the act, which expressly authorizes the Board to provide adjustments and exceptions for any class of electronic fund transfer that in the Board's judgment are necessary or proper to carry out the purposes of the act or to facilitate compliance.

Although the language of § 913(1) appears unequivocal, the Board notes that there is legislative history indicating that exceptions may exist. The Senate report (95th Congress, 2d Session, Report No. 95-915) expressly permits creditors to offer incentives to induce the election of automatic payments. In the case of overdraft credit, the Board believes that the incentives relate in part to the benefits that consumers derive from the availability of overdraft checking. Further, there is little evidence of consumer complaints. It is arguable that the popularity of overdraft credit plans, which almost universally have involved an automatic payment feature, is some indication of the acceptability of automatic debiting in the narrow circumstances to which the exception applies.

As adopted, the amendment creates an exception to the compulsory use prohibition with respect to credit extensions under overdraft credit plans, or plans in which an extension of credit occurs automatically to maintain an agreed-upon minimum balance in the consumer's account.

The wording and format of the amendment differ from the proposal that was published in October. The references to §§ 913, 915, and 916 have been deleted from the text of § 205.3(d)(2) and (3) and incorporated in a new

footnote numbered 1a. This change permits the exception applicable to overdraft credit plans to be stated in a more straightforward, less cryptic manner than was possible under the previous format. The revision to § 205.3(d) is purely editorial, with no change in substance.

A number of commenters noted that under some plans, overdraft extensions of credit are charged to the same open-end account as extensions of credit that the consumer may obtain in other ways. For example, cash advances may be debited directly to the credit line, without going through a checking account. The exemption applies to such plans; it does not seem practicable to try to distinguish between extensions of credit that are triggered under such plans because of the overdraft mechanism and those that are advanced to the consumer by other means.

(5) Pursuant to the authority granted in 15 U.S.C. 1693b, the Board amends Regulation E, 12 CFR Part 205, effective January 15, 1981, by redesignating footnote 1 as footnote 1b and by revising § 205.3(d) to read as follows:

§ 205.3 -- Exemptions

* * * * *

(d) Certain automatic transfers.***

(2) Into a consumer's account by the financial institution, such as the crediting of interest to a savings account;^{1a/}

(3) From a consumer's account to an account of the financial institution, such as a loan payment;^{1a/}

^{1a/} The financial institution remains subject to § 913 of the act regarding compulsory use of electronic fund transfers. A financial institution may, however, require the automatic repayment of credit that is extended under an overdraft credit plan or that is extended to maintain a specified minimum balance in the consumer's account. Financial institutions also remain subject to §§ 915 and 916 regarding civil and criminal liability.

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By order of the Board of Governors, January 8, 1981.

(signed) Theodore E. Allison

Theodore E. Allison
Secretary of the Board

[SEAL]