

Testimony of John P. Carey
Citigroup North America Consumer Banking
Senate Committee on Banking, Housing and Urban Affairs
November 17, 2009

Good afternoon Chairman Dodd, Ranking Member Shelby, and Members of the Committee. My name is John Carey, and I am the Chief Administrative Officer of the Citigroup North America Consumer Banking business and am responsible for, among other things, the business practices of Citibank, North America. I appreciate the opportunity to appear before you today to discuss our views on the Fairness and Accountability in Receiving (FAIR) Overdraft Coverage Act (S. 1977) and to offer recommendations for improving customer choice in and protection by overdraft coverage.

Citibank serves more than 4 million customers in our retail banking business and has a network of more than 1,000 branches, 3,200 Citibank proprietary ATMs, and an additional 23,000 surcharge free ATM's available to our customers through various partnerships.

As we will discuss today, the policies that most banks employ when applying overdraft protection policies, most particularly for ATM transactions or debit purchases, can be very confusing, frustrating, and too expensive for consumers, particularly for those people who don't closely manage their daily finances. We have all heard stories about consumers being caught unaware and incurring unexpected fees for transactions they could have easily avoided with greater transparency at the point of sale.

So let me be clear – at Citibank, we help customers avoid overdraft fees. We decline ATM transactions or debit purchases when sufficient funds are not available to cover the transactions. Therefore we do not charge overdraft fees when a customer attempts such a transaction.

At Citibank, we believe that we have an obligation to our customers to be fair and fully transparent and to use practices and disclosures that are clear and easy to understand. In many cases, overdraft fees can be avoided. To that end, I will highlight some important observations about consumer behavior and preferences describe our position and practices relative to overdraft protection, address some of the key aspects of the current bill that will adversely affect our customers and the industry at large, and offer some solutions for how consumer concerns around overdraft services could best be addressed.

When banks enter a relationship with a consumer, they take on a significant responsibility: to provide tools and services that make fundamental day-to-day financial activities easier, more convenient, and beneficial to consumers, while providing value to customers for the value they bring to banks with their business. Most banks provide their customers with instant access to their funds through branches, ATMs and online banking services. Moreover, most banks provide their customers with financial expertise and

assistance through their representatives and a wide range of tools that support better money management.

At the same time, it is impossible to provide a wide variety of banking services to the public without assuming some risk. Therefore, it is the responsibility of both the customer and the bank to work together to mitigate those risks. The services that banks provide regarding overdrafts are an important component of the basic banking relationship and in mitigating risk. Responsible money management ultimately must lie in the hands of the consumer, because it is the individual consumer who has immediate control and knowledge of his finances and accounts. We recognize, however, that it may not always be practical for customers to keep track of every purchase. There are ways to make purchases that operate in different timeframes (for example, instant PIN debit purchases vs. check processing or scheduled payments), and merchants have a wide range of processing options that add complexity, so banks have widely instituted the service of occasionally covering transactions through overdraft payments.

In thinking about overdraft services, it is important to distinguish ATM transactions or debit purchases from other transactions such as checks and Automated Clearing House (ACH) transactions. The frustration that consumers express is centered on those ATM or debit transactions where the overdraft fee could have been avoided, if the customer had only known at the ATM or point of sale that the transaction would result in the assessment of an overdraft fee.

Conversely, customers find overdraft services for checks and ACH transactions to be a valuable service. They prefer to have their bank cover the occasional overdraft payment of a check for a fee, rather than having the check returned, receiving an insufficient funds fee, an additional bounced check fee imposed by a merchant for the returned item, and the possibility of negative impact to their credit report.

Overview of Citibank Overdraft Policies and Practices

For Citi, our guiding principle to overdraft payment services is simple: we help our customers effectively manage their finances and avoid spending money they don't have in their accounts. That's why for ATM transactions or debit purchases (both PIN-based and signature-based), where balances can be instantly checked electronically, we will not authorize a transaction when the customer does not have the funds to spend in his account.

Separately, we do allow overdrafts for checks and ACH transactions. We do this because the situation is very different. With checks and ACH transactions, the customer has the sole control over those transaction requests; we cannot know what amount they are writing on a check or exactly when they have written the check. In those cases, we mitigate risk for our customers and ourselves by allowing customers a cushion that covers a small overdraft. In order to avoid large overdraft situations, Citi will not authorize payment beyond a reasonable amount.

Moreover, we encourage customers to link other accounts or lines of credit to cover potential overdrafts and avoid either an overdraft fee or a bounced check fee. Overdraft/NSF fees help cover the cost of processing the transaction, cover the risk of possible loss, cover the cost of an interest-free advance of funds, as well as provide an incentive to customers to not spend more than they have in their account, or to use the other, lower-cost services we have that can cover potential overdraft transactions.

We have also made other important policy decisions to ensure our overdraft protection is fair. We instituted a cap of four fees per day (which also includes insufficient funds fees) in early 2008; fees that for Citibank generally would arise only if a customer drew multiple checks where funds were unavailable. We do not do “continuous overdraft”, where a bank will impose an additional fee on an overdraft if the overdraft remains on an account after a certain period of time. Finally, because we track electronic debits instantly, we have established a processing order that is beneficial for our customers.

Customer Needs and the Importance of Choice

As technology has improved and customers expect more choice in their banking, Citibank has gone to great lengths to provide tools to help customers manage their finances. In addition to providing alerts and instant access to balances online and through mobile services, we make sure that our customers’ transactions are updated in real time so that customers can move money as needed to cover payments. Our customers are able to see credits or the electronic purchase they made at the grocery store reflected immediately in their available balance. And, we know they avail themselves of this service as a significant number of customers make transfers at branches, online, or at ATMs every day to cover potential overdrafts they are able to see happening during the day.

In addition, a third of our customers have signed up to link a line of credit or savings account to their checking accounts, which can be used to cover overdrafts in addition to simply being used for savings or as additional credit to draw upon. We encourage the establishment of these services at account opening and throughout our relationship with our customers. Our personal bankers are in fact incented to encourage customers to open additional savings accounts and lines of credit to cover overdrafts. When a *customer* uses these services to cover overdrafts proactively, there are no additional fees charged; when *Citi* covers the overdraft for them using these accounts or lines, a nominal fee is charged. Finally, many of our customers have signed up for low-balance alerts, which help them avoid unnecessary bank fees.

Today fewer than 20 percent of Citibank customers are charged even one overdraft fee in a year. Of those, only a few are charged more than once annually. We believe a reason for this is due to our practice of NOT authorizing ATM and Debit transactions when funds aren’t available. Fortunately, our customers continue to do a good job of managing their accounts, and, with tools such as the ones we offer to protect them from overdrafts, we believe that behavior will continue. Still, it is our fundamental

belief that choice and control around overdraft fees should lie squarely in the hands of informed customers.

Views on Pending Legislation

In general, we fully support the bill's goals of protecting consumers from unnecessary overdraft fees. . We believe that consumers need transparency, especially at the transaction point in order to make informed choices about incurring such fees. That is why we support additional efforts to improve consumer awareness regarding overdraft protection and alternative payment options to help people be smart and responsible about money management.

Moreover, we agree that banks should provide more transparent and easy-to-understand disclosures so that consumers can better manage their own money. For us, meaningful customer choice and control are paramount, and customers should be able to choose if they need to overdraft or not.

We also believe, however, in the importance of giving customers the ability to make choices based upon their individual circumstances as they manage their finances from one day to the next. That is why we support a requirement for interactivity of ATM screens that allow customers to choose whether to continue with a transaction and pay a fee for insufficient funds or terminate the transaction. We also see enormous value in finding a similar solution for debit transactions. We believe that the recent changes to Regulation DD that will go into effect in January of next year, requiring statements to tally overdraft and insufficient funds fees for customers annually, will go a long way towards raising further awareness about the costs to consumers for spending funds they don't have.

Our concerns regarding the bill are as follows:

Opt-in and Notification Requirements

Most customers do not overdraft and never will. However, customers may not fully understand the effect that opting into or out of overdraft coverage will have on them when they open an account and choose *not* to “opt-in” to overdraft coverage. In the future they may find themselves in a circumstance where they wish they could proceed with a specific transaction even if they know they would be charged a fee. So for example, it isn't that \$5 cup of coffee that ends up costing \$40, but rather that being stranded without cash in a foreign country and being able to access \$100 from an ATM that will cost them \$135. Having previously “opted-out” would eliminate that flexibility.

So it is our position that customers should be given the choice of “opting-in” *at the point of transaction instead*. Customers should be alerted when an ATM or debit transaction will overdraft an account, and they should be able to choose at that moment whether they need to continue with that transaction and incur the associated fee or not.

Understandably, updating the technology to provide such transparency will take time and it will be incumbent upon the merchants, the networks, and the banks to help create the functionality allowing for this practice at the transaction point.

Until then, perhaps all banks should be required to deny ATM and debit transactions that will trigger an overdraft fee, a practice that Citi follows today. Giving the customer the choice to overdraw and incur the fee at the time of the transaction – *the moment of truth* – we believe, provides the best possible notice. In the absence of the technology to provide this notice, the transactions should simply be denied.

Separately, we have concerns about the same-day notification requirements contained in the bill, especially given the amount of detailed information that would be required. This kind of notification would be nearly impossible to achieve technologically, and additionally may not be relevant, above and beyond communication tools that already exist. By way of example, many customers overdraw their account early in the day, but through the course of the day have either made transfers or deposits to cover the overdrafts. This tells us that these customers are managing their financial circumstances appropriately, making the communication potentially unnecessary or even inaccurate. Because many transactions such as checks are received after hours and most ACH transactions are processed overnight through posting reconciliation, a notification would not be timely enough for the customer to respond. In the final analysis though, we believe that customers should manage their finances effectively and use the many tools we already provide to achieve those goals.

Limitation of Fees Assessed to One Per Month and Six Per Year

The bill's provision that would limit the number of fees assessed is complicated by network merchants' rules that govern how banks process certain transactions. Many times a bank cannot control and therefore must allow overdrafts. The most prevalent example of this is for settlements of signature-based debit transactions. If this limitation is meant to impose restrictions on practices such as "continuous overdrafts", it also has the consequence of preventing banks from collecting appropriate compensation for transactions they are required to honor with merchants, but bear the entire risk of potential losses. It is impossible for banks to predict which customers will be responsible for those losses, so a very real result may be that banks eliminate payment of overdrafts, including checks and ACH transactions, so that some of the settlement risk is covered. Again, the result will be harm to customers through additional merchant fees and the consequences of unpaid bills. For customers who intentionally and fraudulently create overdrafts, they would soon learn that they can "get away" with doing so at a fixed cost to them, which eliminates the effectiveness of overdraft fees as a deterrent.

We suggest that if the bill is attempting to limit "continuous overdraft" fees for a single overdraft, the legislation be focused to specifically address that practice. Moreover, we believe that by requiring customer choice at the ATM or point of sale whether or not to incur an overdraft fee before authorizing a transaction, customers are in complete control. Absent that choice, the transaction should not be authorized. Finally,

for ATM transactions or debit purchases, we believe that the limitation on fees should apply only to those fees incurred through ATM transactions and debit purchases and not apply to ACH and check transactions.

Limitation on Fees Created by Holds and Settlements

Since authorization amounts, or holds, are entirely controlled by merchants, banks have no way of anticipating the actual intentions of customers when they are performing a transaction. Two common examples of this are gas station purchases and hotel stay purchases. Although a gas station may only authorize \$1 to allow a customer to pump gas, the settlement amount will almost always be larger. In this case, we believe that merchants should request authorizations that are greater than \$1 and indeed ought to consider an amount closer to the average transaction purchase at the pump. This should be an easy change for gas stations to make, and it would go a long ways towards reducing customer inconvenience. Moreover, at some level, the customer must also accept responsibility for knowing whether or not they have sufficient funds in their account to buy the gas. Banks can only authorize what is presented to them by the merchant, and have no way of knowing for what amount the ultimate transaction will settle.

In the case of a hotel stay transaction, the merchant may seek authorization for an amount that exceeds the cost of the customer's actual stay, and only the merchant is in a position to know or communicate to the customer what the amount of the hold will be and ultimately the amount of the settlement. Regardless, banks must in the meantime continue to process other intervening transactions based upon the authorization request that was submitted by the hotel. This challenge was recognized by the Federal Reserve Board in its recent amendment to Regulation E. These issues could be minimized through changing the way merchants process these transactions, by either seeking authorizations that more closely reflect the cost of the ultimate transaction or changing the way they process the transaction. We believe that some effort should be put into developing better controls and rules regarding merchant hold processing, and providing guidelines that could be much more effective in terms of protecting consumers.

"Reasonable and Proportional Costs"

The bill recommends that a study be performed to understand what the reasonable and proportional costs are of overdraft protection to overdraft fees. Our request is that the study address all costs associated with overdraft procedures, certainly including risks and losses, but also including additional costs born today. For example, on a daily basis we review accounts and intervene on behalf of good customers before overdraft fees are assessed, and if the report were not to factor such overhead costs, we may have to stop providing that type of customer service. Moreover, we believe that if the bill actually prohibited overdraft ATM transactions or debit purchases (both PIN-based and signature-based) unless the customer has the opportunity to opt in at the point of sale, the debate around the reasonable and proportional costs gets clearly placed in the consumer marketplace rather than through government imposed price controls.

Posting Order

We strongly believe that our posting order presents a fair and simple means of processing customer transactions, which they can easily understand. The problems that consumers report are when **all** transactions are bundled and then processed from high to low. We believe that by processing credits first, electronic payments as they come in, and then processing ACH transactions and checks from high to low, overdraft fees are minimized and the important transactions such as mortgages and car payments are covered. This practice is in our customers' best interests. Attempting to process all transactions chronologically, particularly with checks, would be very difficult, as checks are processed in batch, and we do not know what the customer's particular intentions were regarding order of payment.

Conclusion

As I have noted, we find merit to the overriding goals of this bill and we believe that customers should have informed choices before incurring debit overdraft fees. Obviously, the ultimate goal is for customers to manage their finances carefully and never overdraw their accounts. Nevertheless, for the reasons noted above, we believe that the legislation may not fully address the concerns that consumers have with debit card overdraft fees.

Thank you for the opportunity to share our ideas with you.