Consumer Federation of America

Testimony of

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On

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Thank you for the opportunity to testify today on modernizing the Community Reinvestment Act (CRA). My name is Barry Zigas. I am Director of Housing Policy at the Consumer Federation of America (CFA). CFA represents 280 state and local consumer organizations and provides policy development and analysis services on a wide range of consumer issues, including consumer finance, especially as they affect low and moderate income consumers.

The CRA has been an important element in assuring that all households have access to safe and affordable credit. When it was originally adopted in 1977, the notion that all lending institutions that take deposits from communities should have an obligation to provide those communities with a full range of credit services was not universally accepted. But today, after many years of work by community organizations, regulators, lenders and others, this should not be a controversial position. Indeed, while *lack* of credit in low and moderate income neighborhoods, and communities of color, was the major concern when CRA was debated and adopted, since then we have learned once again that it is possible for communities to suffer from *too much* credit. The flood of irresponsible, expensive and unstable credit that was offered at the height of the mortgage boom in the last decade exemplifies the notion that bad money will drive out good money in the absence of sensible and enforced regulation.

We agree with the consensus opinion of every federal financial regulator that CRA was not a significant contributor to this flood of credit. Indeed, we believe that lenders that were trying in good faith to offer responsible and stable products were out-sold by less scrupulous capital sources. At the same time, some CRA-regulated institutions took advantage of loopholes in CRA coverage to join this trend through acquisitions and affiliations that enabled them to profit from lending practices that would not have been countenanced under a CRA review that took into account the totality of the institution's business.

The collapse of these alternative financing channels is an excellent opportunity to rethink and modernize the CRA. We thank you and your colleagues for holding these hearings and soliciting comments from the public as you consider how to go about this. In addition to regulatory modernization, we believe that legislative reforms also are necessary. I would like to offer a few broad suggestions for areas that we think are in immediate need of reform.

Assessment Areas

The banking world of 1977 was very different than the one in which we live today. CRA was conceived to require what were generally *local* institutions that raised capital from deposits to reinvest it to meet the credit needs of their entire community. There was plentiful evidence at the time that conventional institutions used stereotypes and standards that excluded some communities and residents within those communities from having access to credit. The definition of the service area against which the CRA would be judged therefore was primarily focused on the areas from which lenders drew those deposits.

Such a narrow conception of a lender's service area is no longer sensible. Large parts of the country today are served by lenders operating in many areas within a state, and in many different states. Deposits can be drawn from the entire country. Yet service areas for CRA compliance are narrowly drawn and fail to reflect the scope of market penetration many of these lenders actually enjoy. CRA reviews and evaluations consequently reflect an incomplete and sometimes haphazard picture of a lender's actual marketplace and footprint. This is bad for communities and for lenders. The former can be left out of a review entirely even when an institution has a large presence, directly or through affiliates, frustrating CRA's core purpose. Lenders can be faced with multiple reviews over many areas that do not necessarily reflect the full scope of their business. These reviews can be time consuming and very costly, and yield only a fragmentary picture of the lender's business and success at meeting the credit needs of the communities in which it operates. By restricting reviews to those areas where banks have branches CRA necessarily misses many areas that are served by lenders through intermediaries, brokers and others. The emergence of internet banking, industrial banks that operate widely but have branches only in one location, and customer service through ATMs means that consumers can be located in areas without a branch but still be interacting in many of the same ways as those located near one. This shift in the banking landscape means that actual coverage of banks' business has shrunk. One estimate states that the number of home loans covered by CRA exams actually has shrunk by as much as 25 percent since CRA's inception.[1]

CRA regulatory oversight should be designed to capture most, if not all, of a lender's activities across whatever geographies it operates in. This will require a significant rethinking of the means regulators use to assess performance. Credit needs in all localities are not the same in degree or type. Applying a "one size fits all" approach could distort incentives for lenders to emphasize certain types of lending regardless of their appropriateness in different circumstances. Wider use of needs assessments generated by both lenders and regulators against which CRA performance can be measured is one possible solution to this problem. Another is more standardized protocols for regulators that will reduce uncertainty for lenders in the review of performance against such performance plans. The Federal Housing Finance Agency (FHFA) recently has proposed a rulemaking for a CRA-like "duty to serve" by Fannie Mae and Freddie Mac that includes such an advance assessment and plan for action against which performance can more meaningfully be measured. While these secondary market entities differ significantly from CRA-covered lenders, the model is worth closer examination.

Another way that regulators could encourage investments in areas that are outside the scope of larger institutions today is to identify them in advance of reviews and consider activities that benefit them and demonstrably increase the flow of credit to them for greater weight in CRA exams. This more strategic approach would enable regulators to better match their reviews to expected outcomes, and enable lenders to clearly and accountably describe how they plan to serve the communities in which they operate.

Coverage of Affiliates

Another change in the banking landscape since 1977 has been the merger of many institutions into a smaller number of very large ones, and the development of affiliate relationships through which one lender may operate multiple lines of business in multiple geographies. Yet CRA currently does not facilitate coverage of the total book of such lenders' business. Instead, these multiple entities may have separate CRA reviews, by multiple regulators, under different terms depending on their size, or no CRA review at all. Yet from a business point of view, all of these entities are the means through which the parent company carries out its business. Wells Fargo, for instance, is listed in Home Mortgage Disclosure

[1] Ren Essene of the Federal Reserve Bank of Boston and William C. Apgar of the Joint Center for Housing Studies, Harvard University, *The 30th Anniversary of the CRA: Restructuring the CRA to Address the Mortgage Finance Revolution*, in Revisiting the CRA: Perspectives on the Future of the CRA, eds. Prabal Chakrabarti et al., A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, 2009

Act (HMDA) data as the owner of more than 200 separate affiliated lending institutions. It is virtually impossible to form a clear picture of any lender's performance in meeting the CRA's intent while these subsidiary entities are not consolidated in the review.

A modernized CRA should consider taking affiliate activities into account when assessing a covered institution's activities.

Assessment Grades

The current limited set of choices for assessing CRA performance has led to a clustering among lenders of "satisfactory" and "outstanding" ratings that have robbed them of much of their meaning. Regulators should develop a more nuanced set of assessment grades. These would permit regulators to take into account more circumstances and outcomes and encourage or discourage activities that might otherwise be masked in the larger and less descriptive ratings that are available today. One possibility is to add a "high" and "low" rating to the current "Satisfactory." Another would be to separately assess different major categories. In addition to measuring the quantity of loans, for instance, a review might more clearly assess the suitability of the loans available given the circumstances of the community; the process through which loans are made available; the range of credit opportunities and whether sustainable, innovative products are offered; their likely relative impact on the community in which they are made; and so on.

We also recommend that CRA reviews examine the quality and suitability of lending carried out in service areas and use such assessments in assigning a performance grade. Refund anticipation loans, payday loans and other forms of abusive and high cost credit should not be rewarded with high CRA performance grades. Conversely, wide distribution and marketing of stable, responsible lending products that meet the needs of community residents should be rewarded and encouraged. Reviews may have to be expanded to examine both affiliate activities and funding activities through which covered lenders provide capital, but not direct loans, that supports abusive lending practices in their footprints.

Deposit and Savings Services

CRA's major focus is on lenders' performance in extending credit in the communities where they are located. But the prevalence of expensive, nontraditional banking services in low and moderate income and minority communities is testament to the difficulty many households have in obtaining and using safe and affordable savings and deposit products. CRA exams should take into account both the quality and quantity of these services offered by covered lenders. These can be taken into account now through the Service Test, and we encourage more and closer examination through it. Legislation may be necessary to fully enable regulatory oversight in these areas, but we believe strongly that consumers need access to these services and are in many cases not receiving them.

In addition, we note that many consumers can be saddled with very high transaction costs for even standard deposit services. The recent regulatory changes requiring that lenders solicit an "opt in" from consumers to provide overdraft loans for debit and ATM transactions is a sobering illustration of this problem. A recent CFA survey of bank overdraft fee policies and schedules documents that the burden still falls on consumers to avoid usurious charges for overdraft services, for instance. Some lenders, like Bank of America, USAA and Citigroup have decided not to offer an opt-in feature for consumers, and we applaud their leadership. Others, however, have been soliciting consumers with offers for such services that come with high costs, even when the overdraft is small and the consumer may be unaware of having triggered it. I would like to include a copy of the press releases summarizing CFA's recent survey of overdraft and opt-in policies for the record. We urge you to consider taking such policies into account and lowering overall ratings for lenders that consistently charge high fees and saddle consumers with repeating charges that generate usurious interest rates on loans that consumers did not specifically seek or apply for.

Enforcement Mechanisms

The principal punishment for poor CRA performance is the possibility of denial or delay of applications for mergers and acquisitions. While this has been a powerful incentive for lenders to seek high CRA ratings in the past, its power has diminished over time. The very largest lenders with the most coverage are unlikely to seek a significant number of these actions in the future. Regulators should consider using other means to reward good CRA behavior and punish records that lag the norm. One possibility is to charge those with poor CRA ratings higher regulatory assessments or premiums for federal deposit insurance. Both of these are part of the bundle of benefits that regulated institutions receive. It is not inappropriate to differentiate the cost of such benefits based on lenders' willingness and ability to meet their obligations to the communities they serve.

We also endorse recommendations from the National Community Reinvestment Coalition (NCRC) to boost the rigor of the fair lending reviews that probe for evidence of illegal and discriminatory lending. Fair lending reports on CRA exams must be detailed explanations of the fair lending tests used instead of the one or two sentences currently on most CRA exams. In addition, regulators should consider expanding the concept of illegal and discriminatory lending to include unsafe and unsound lending. Banks have failed CRA exams because they made or financed unsafe loans; the fair lending review must routinely indicate whether the review found evidence of unsafe and unsound loans.

Modernization of CRA regulation is a critical part of recalibrating how consumer banking works in the aftermath of the financial crisis. We appreciate the opportunity to share our views through this hearing and look forward to working with you as you develop your policies.

June 29, 2010 Contact: Jean Ann Fox, CFA, 928-772-0674

Consumers Warned Not to Opt In as Banks Market Expensive Debit Card Overdraft Fees

Federal Reserve Rules Take Effect July 1 for New Accounts

Washington, DC --- The Consumer Federation of America (CFA) today released information to help consumers decide whether to opt-in to bank overdraft fees for debit card purchases and ATM withdrawals. CFA updated a survey of the largest fifteen banks' overdraft fees and limits, reviewed bank overdraft opt-in forms, and calculated the total cost to consumers of a single debit card overdraft.

New rules issued by the Federal Reserve require banks to get consumers' permission to charge overdraft fees for single debit card purchases and ATM withdrawals. These rules become effective July 1 for new accounts and August 15 for accountholders. Banks can continue to charge overdraft fees for checks, preauthorized electronic payments, and recurring debit card transactions without customer consent. As the deadlines near, banks that make $23 billion a year in overdraft revenue are rolling out changes to overdraft programs as they vigorously market debit overdraft opt-in.

"Bankers are asking their customers to sign up for their most expensive form of overdraft coverage. Consumers should just say no to these astronomical fees," noted Jean Ann Fox, director of financial services for Consumer Federation of America.

Major Banks Opt Out of Opt In

A few major banks, such as Bank of America, Citibank and USAA, are not selling debit and ATM overdraft coverage. These banks deny ATM and single debit card transactions that exceed the funds in an account. These banks help consumers manage their money and avoid unexpected steep fees. Chase does not permit overdrafts at the ATM, but is aggressively marketing debit card purchase overdraft.

"Banks should not permit consumers to spend more than they have in their accounts," Fox stated. "Debit overdraft fees typically cost more than the amount overdrawn." The average debit card purchase overdraft is just $20 while the typical big bank overdraft fee is $35.

Banks Revamp Fees, Drop Lowest Fees

In order to encourage consumers to opt-in, banks are simplifying their complicated overdraft fee structure. Unfortunately, they are eliminating the lowest fees in the process. Since February, Chase, Citizens/RBS, Regions, and US Bank have eliminated or collapsed tiered fees. Chase now charges a flat $34 overdraft fee instead of fees ranging from $25 to $35. Wells Fargo dropped its initial $25 fee and now charges $35 for each overdraft. Fifth Third Bank retained its fee tiers, charging $25 for the first overdraft, $33 for two to four overdrafts, and $37 for five or more overdrafts in a year.

The typical big bank overdraft still costs $35, with the banks' top fees ranging from $33 at US Bank to $37 at Citizens/RBS and Fifth Third Bank. The only significant fee cut is by US Bank which dropped its fee for overdraft amounts of $20 or less to $10, with larger overdrafts costing $33. Previously, US Bank charged tiered fees of $19 to $37.50 each.

Banks Charge Twice for the Same Overdraft

Nine of the fifteen largest banks charge a second fee if consumers have not repaid the original overdraft and fee within a few days. These "sustained" overdraft fee ranges from a flat $15 after five days at Chase to $36 at SunTrust if an overdraft is not repaid in seven days. Other banks charging their customers twice for a single debit overdraft include BB&T ($30 after seven days), US Bank ($25 per week) and TD Bank ($20 on the 10th day.) Three large banks charge per-day sustained overdraft fees. Citizens/RBS adds $6.99 per day on the 4th through 13th day that an overdraft remains unpaid. Fifth Third adds $8 per day after three days and PNC Bank charges $7 per day after four days up to a maximum of $98.

Multiple Fees for A Single Overdraft Add Up

Consumers asked to opt in to debit overdraft fees may not realize the total amount they are agreeing to pay. The total cost of one $10 overdraft paid in ten days adds up to $85.93 at Citizens/RBS and $93 at Fifth Third. The combination of original and sustained overdraft fees makes a single debit card overdraft cost $78 at PNC, $72 at SunTrust, and $65 at BB&T. Due to US Bank's lower initial fee for small overdrafts, a $10 ten-day overdraft costs $35 while a $21 ten-day overdraft costs $58.

"Banks should be prohibited from piling on multiple fees," Fox noted. "Overdraft fees have no connection to the amount of credit extended or the bank's cost to cover transactions."

Bank Limits on the Number of Overdraft Fees Provide Little Protection

Most large banks set a maximum number of overdraft fees that can be charged per day and some set a dollar threshold amount that triggers a fee. Even with these limits, banks can still pile on the overdraft fees in a single day. For example, Regions Bank starts charging fees if the total overdraft per day exceeds $5, and limits to four the number of overdraft fees charged in a day. A consumer who opts in to Region's debit card overdraft program, therefore, agrees to pay up to $140 in a single day for as little as $5.01 total overdrawn in four debit card transactions. A consumer opting in at Fifth Third Bank could owe $370 in just one day. HSBC sets no limit on the number of $35 overdraft fees it charges per day.

"The Federal Reserve does not require banks to quote the total fees consumers can rack up per day," noted Fox. "Consumers who check the opt-in box are not likely to know how much they can owe their banks for a series of very small overdrafts."

High Fees and Short Repayment Terms Make Overdrafts Pricey "Loans"

Banks use their funds to pay overdrafts and charge consumers for the use of the bank's funds which should make these credit transactions. However the Federal Reserve does not require banks to comply with the Truth in Lending Act (TILA) or quote the APR for these overdraft "loans." Banks use a process called "set-off" to take payment directly out of the next deposit to consumers' accounts, making overdrafts the bank equivalent of a payday loan… an extremely expensive cash advance based on access to the borrower's bank account and due in full on the next payday.

CFA calculated the APR for a $100 debit overdraft using each bank's top fee plus any sustained overdraft fees if repaid in two weeks. If computed as a closed-end payday loan, bank overdraft fees translate to APRs ranging from 910 percent at Capital One, HSBC, and Wells Fargo/Wachovia to 3,250 percent at Fifth Third.

"Consumers don't get APR disclosures to help them compare the cost of an overdraft loan with other forms of credit," Fox noted. "Without TILA protection, banks have first claim on their customers' next deposited paychecks or Social Security benefits to repay overdrafts and fees."

Opting Into Overdrafts Doesn't Guarantee Protection

Banks are selling debit card overdraft coverage as a way consumers can make sure single debit purchases and ATM withdrawals are honored, and to avoid the embarrassment of having a debit card purchase denied at check-out. But banks make no guarantee to consumers opting into debit card overdrafts that each transaction up to a set amount will be covered. Federal Reserve rules permit debit card overdraft coverage to be discretionary on the part of the bank. Bank opt-in forms make clear that banks can deny coverage of transactions and that consumers cannot count on having overdrafts paid.

Lower Cost Overdraft Options Available

All of the largest banks provide much lower-priced overdraft options, including transfers from savings accounts and credit cards, as well as lines of credit. The Federal Reserve opt-in form requires banks to disclose their options, but not to present the cost of each option in an easy to compare format. Most large banks charge $10 to transfer funds from savings to pay all overdrafts at the end of the day. Overdraft lines of credit typically cost 18 percent per year, not 910 percent for a two-week overdraft "loan." Banks are not required to clearly disclose that the cost of not opting in to debit card overdraft coverage is **zero**.

"CFA advises consumers to pitch out their banks' opt in forms for debit card overdraft coverage," Fox said. "Keep a cushion in your account, sign up for text or email alerts, and link checking to your savings account to avoid paying $35 for $5 overdrafts," Fox urged.

The Consumer Federation of America is a non-profit association of more than 280 groups that, since 1068, has sought to advance the consumer interest through advocacy and education.

Attachments: CFA Survey of Big Bank Overdraft Fees and Terms
CFA Bank Debit Card Overdraft Total Costs and APRs
CFA Overdraft Advice for Consumers Brochure