Consumer Federation of America

October 16, 2006

Mr. Steve Hanft
Legal Division
Federal Deposit Insurance Corporation
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Washington, DC 20429
FAX: (202) 898-3838
EMAIL: comments@fdic.gov

Re: **Study of Overdraft Protection Programs**

Dear Mr. Hanft:

I am writing on behalf of Consumer Federation of America (CFA) in response to the notice and request for comments on the FDIC's proposed one-time collection of information on bank overdraft products and practices. CFA is a national non-profit association of about three hundred consumer organizations, founded in 1968 to advance the consumer interest through research, advocacy and information. We are very concerned about consumer access to safe and affordable bank accounts, opportunities to build assets, and protections against predatory small loans. **CFA supports the FDIC study of overdraft protection programs.**

We have been actively involved in the regulatory dockets that addressed bank overdraft loans in recent years. CFA conducted studies and filed comments in two Federal Reserve Board regulatory proceedings on bank overdraft loans.[1] CFA published a study of bank overdraft and insufficient funds fees and practices in 2005[2] and conducted a national opinion poll in late 2005.[3]

We commend the Federal Deposit Insurance Corporation on its leadership in addressing the important public policy issues and information gaps around bank

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[1] "Consumer Federation of America Review of Bounced Loan Advertisements and Disclosures," filed with the Federal Reserve, Comments of the National Consumer Law Center, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates and Woodstock Institute to the Federal Reserve on 12CFR230 Docket No. R-1197, Proposed Amendments to Regulation DD, August 6, 2004. Also, see CFA and National Consumer Law Center, "Bounce Protection: How Banks Turn Rubber Into Gold by Enticing Consumers to Write Bad Checks," 2003.
[2] Jean Ann Fox and Patrick Woodall, "Overdraft: Consumers Face Hidden Overdraft Charges From Nation's Largest Banks," CFA, June 9, 2005.
[3] Poll of 2038 representative adult Americans, conducted by Opinion Research Corporation, November 3-7, 2005.

products and practices when accountholders overdraw their accounts. The spread of non-contractual overdraft loan programs in recent years has sparked controversy about the bank equivalent of payday lending, bank practices in processing debits, and the lack of affirmative consumer consent or knowing use of bank overdraft credit products.

The FDIC's study will ask for essential information from five hundred banks, plus more extensive information from one hundred of those banks, and will provide unbiased information essential to future public policy decisions and safety and soundness supervision by regulators. FDIC should make public its findings to further the public discussion of appropriate consumer protection and bank regulation.

1. Overdraft and Insufficient Funds Fees Cost Consumers Billions per Year

The single largest portion of non-interest income for banks is their service charges on deposit accounts, largely insufficient funds and overdraft fees. In 2005, the FDIC reported that bank and thrift deposit service fees totaled $34.5 billion, or 15.5% of non-interest income.[4] An industry analyst, Moebs Services, told the Federal Financial Institution Examination Council in mid-2004 that all financial institutions' overdrafts created $33 billion in revenue, or 19.1% of those institutions' net income.[5] The Center for Responsible Lending conservatively estimates the cost of fee-based non-contractual overdraft loans to consumers of over $10 billion. Whichever figure turns out to be accurate, it is clear that overdraft fees and products are a major revenue stream for banks and a serious financial burden on consumers.

The FDIC's Call Reports do not require banks to separately report insufficient funds fees or overdraft loan fees. In additional to collecting total insufficient funds revenue in this study, CFA recommends that Call Reports in the future require all banks to separately report both NSF and overdraft fee revenue.

2. Federal Regulations Fail To Protect Consumers, More Information Needed to Inform Regulation and Legislation

Federal overdraft regulations currently do not protect consumers. Despite acknowledging that banks extend credit when overdrafts are covered, the Interagency Joint Guidance merely provides "best practices" for banks to follow when offering non-contractual fee-based overdraft loans to consumers.[6] These best practices fail to prevent usurious extensions of credit, do not provide for affirmative consumer choice, are not enforceable regulations, and do not close the Federal Reserve Board's loophole that exempts non-contractual overdraft loans from Truth in Lending Act disclosures. In adopting its Final

[4] FDIC Statistics on Depository Institutions Report, available at www2.fdic.gov/sdi/, accessed October 16, 2006.
[5] Moebs $ervices, Presentation to Federal Financial Institution Examination Council, June 2004, at 1.
[6] Joint Guidance on Overdraft Protection Programs, OCC, Federal Reserve System, FDIC, NCUA, February 17, 2005, p. 7. "When overdrafts are paid, credit is extended." The Office of Thrift Supervision issued separate Guidelines and did not acknowledge that overdraft are extensions of credit.

Rule under Truth in Savings, the Federal Reserve left the door open to applying TILA protections to overdraft loans in the future:

> *The Board's adoption of final rules under Regulation DD does not preclude a future determination that TILA disclosures would also benefit consumers. The Board expressly stated in its proposal that further consideration of the need for coverage under Reg Z may be appropriate in the future.*[7]

The FDIC's study will provide information necessary to evaluate bank compliance with the Interagency "Best Practices," and build the record for reconsideration by the Federal Reserve of its Truth in Lending decision. The study should also be of interest to Congress.

3. The FDIC Has Unique Ability to Collect Information On Overdraft Products, Fees, and Practices

Only bank regulators have the authority and capacity to collect information needed on bank overdraft fees and practices. Last summer CFA surveyed the largest thirty-three banks in the country for a report, collecting information from banks' web sites, supplemented by in-bank requests for checking account fee information. We found that very few large banks make fee or account disclosures available on the Internet, until and unless a full account application is first made. Consumers even had trouble getting account disclosures and fee schedules at bank branches. This scarcity of information contradicts the purpose of Truth in Savings Act, thwarts comparison shopping for bank account features, and makes bank surveys problematic for groups.

Banks' failure to inform accountholders about the order in which they batch process withdrawals argues for the FDIC study. CFA's bank survey found that banks do not generally disclose the order in which they process debits and many stated that they could change their processing order without notice to consumers. One-fourth of surveyed banks refused to disclose any debit processing order beyond "any order," while one seventh of banks reserve the right to process debits in any order but disclose they generally process debits from largest to smallest, and one third disclose they process debits largest to smallest. The FDIC can get behind vague disclosures to document actual bank practices.

4. FDIC Study is Important to Vulnerable Bank Accountholders

CFA commissioned a national poll to learn about consumers who overdraw their bank accounts. Over two thousand representative adults were polled by Opinion Research in November, 2005. We learned that non-contractual fee-based overdraft loan programs are widely used when consumers overdraw their accounts. For those who reported an overdraft in the past year, more than half were paid by the bank with a fee imposed, compared to twelve percent "bounced" at the cost of an insufficient funds fee, and almost

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[7] Federal Reserve, Final Rule, Regulation DD, Docket No. R-1197, May 19, 2005, p. 2

thirty-four percent covered by a contractual overdraft protection plan (such as a transfer from savings, a transfer to credit card, or a line of credit from the bank.)

Lower income, less educated, renting and minority consumers were more likely to overdraw their accounts than their higher-income, more educated, home-owning and white counterparts. Consumers earning below $40,000 annually were 37 percent more likely to overdraw their account than those earning above $40,000 (27.2 percent of lower-income consumers compared to 19.8 percent of upper-income consumers). Generally, those with lower levels of education are more likely to overdraw their accounts, with non-high school schooled consumers more than twice as likely to overdraw their accounts as those with post-graduate degrees (31.6% of those with 8th grade or less and 27.1% of high school graduates reported overdrafts compared to 14.4% of those with post-graduate degree). African Americans and Latinos are twice as likely to overdraw their accounts as white consumers (37.1 percent, 39.0 percent and 18.2 percent respectively). Younger consumers are more likely to overdraw their accounts than older consumers (38.4% of those less than thirty years old reported overdrafts compared to 14.5% of those fifty to seventy years of age). Households with children are more likely to have overdrafts than those without children; about a third of households with children report over-drafting compared to fewer than a fifth of households without children. Renters overdraw at twice the rate of homeowners.

Occupations for consumers who overdraft at a higher rate are clustered in the blue-collar and services jobs. One third of blue collar/craftsmen reported overdrafts, 30.3% of service workers, and 26.6% of white collar/clerical workers, compared to 21.9% of white collar/managers and owners. The concentration of overdraft loan users in lower-paid jobs reflects the findings of the Colorado study of payday loan users.[8] The impact on vulnerable consumers is even more pronounced for frequent over-drafters, defined as those with six or more overdrafts in the last year.

5. FDIC Study is Comprehensive and Appropriate

The research design for the FDIC study is comprehensive and appropriate. The correct bank products are covered: Linked transfer accounts that cover overdrafts by savings or credit card accounts, overdraft lines of credit, automated promoted non-contractual overdraft plans, automated non-promoted overdraft plans, and truly ad hoc bank coverage of overdrafts. This breakdown of plans is necessary to determine the proportion of banks that are subject to the Federal Reserve's TISA rules and to collect information about each type of bank program.

The study asks for the past five years of bank income for all types of insufficient funds programs as well as bank fees charged in each case. This information is important to

[8] Paul Chessin, "Robbing Peter to Pay Paul," *Denver University Law Review*, Vol. 83, Iss. 2 at 387-424. Chessin found that 62.8% of all payday loan borrowers over a four plus year examination of loan applications occupy the lowest three income categories. Laborers account for 30.25% of borrowers, followed by 23.79% in the office worker occupation. Another 8.76 of borrowers were benefits recipients. At p. 406-7.

help regulators gauge the cost to consumers for each type of coverage and the revenue banks receive.

The study design should be expanded to add another option for measuring the impact of overdrafts. Besides asking for the number of accounts and the total dollars charged-off in 2006, the number of deposit accounts and total dollar amount with work out loans, the **FDIC should also ask for the number of accounts that were closed as a result of overdraft loans**. This will help determine whether non-contractual overdraft loans are a barrier to mainstream banking for cash-strapped consumers

The study asks for safety and soundness oversight information and detail about the use of vendors and consultants to design and evaluate bank programs. Banks will be asked to detail their method of informing new customers, provision of comparison shopping information, and customer use educational materials.

Collection of information about overdraft loans made at proprietary and non-proprietary ATMs and at point of sale is particularly important. Prior to overdraft loan programs, a transaction at an ATM or POS that would overdraw an account would have been rejected and no fee charged. As electronic transactions outstrip paper checks, permitting electronic overdraft for a high fee provides a new profit opportunity for banks without consumer choice, knowledge that a particular withdrawal or purchase will trigger an overdraft and fee, and without the opportunity to stop the transaction or provide consent before the fee is imposed.

Clear information on whether accountholders opt in or opt out of each type of overdraft program is important information for Congressional consideration as well as the Federal Reserve Board revisiting its decision not to apply the Truth in Lending Act to these loans.

The data download from one hundred banks of all 2006 checking account customers, their NSF transaction files (including each type of overdraft program), and the lines of credit files will enable the FDIC to answer many questions about how various overdraft programs impact individual consumers. It will reveal how many Social Security deposits are diverted by banks to pay overdraft fees. By collecting census tract identifiers for each account, the FDIC will be able to portray the demographics of consumers who use each type of overdraft program to gauge disparate impact of high cost overdraft loans on vulnerable categories of consumers.

We suggest an addition to Table IIA and to Table IIIA to collect information on the length of time between the overdraft event and payment in full to the bank. Field number 4 on both schedules asks for the date of the NSF item. There is no field that asks for the date of payment. The term of the loan is necessary to determine the true cost of borrowing the bank's money and will shed light on how quickly consumers restore their accounts to a positive balance.

We appreciate this opportunity to submit comments and look forward to receiving the final report.

Sincerely,

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