COMMENTS

of the

Center for Responsible Lending

on

Proposed Rule Regarding Unfair or Deceptive Acts or Practices – Overdraft Practices*

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Regulation AA
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<u>VIA ELECTRONIC SUBMISSION</u>

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*Our comments on the provisions of the Proposed Rule covering credit card practices are being submitted to the Agencies under separate cover.

The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a credit union and a non-profit loan fund.

For the past 28 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to purchase homes. Self-Help has provided over $5 billion in financing to more than 60,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the United States. Self-Help's responsible lending practices keep its annual loan loss rate under one percent.

Self-Help has operated a credit union since the early 1980s. Beginning in 2004, Self-Help Credit Union (SHCU) merged with three community credit unions that offer a full range of retail products,[1] and it now services over 3,500 checking accounts and approximately 20,000 other deposit accounts.[2] It complies with the National Credit Union Administration's (NCUA) regulations on overdraft practices, and it must do so as a relatively small provider of retail services. It will also be required to comply, of course, with any recommendations we make in these comments if accepted. CRL has consulted with SHCU in formulating these recommendations. SHCU is already operating under some of these recommendations, and the rest would be operationally feasible.

SHCU does not offer a fee-based overdraft program, and it denies debit and ATM transactions when the customer does not have sufficient funds. It is currently converting its retail locations from batch processing—where all debit point-of-sale and ATM transactions are processed together twice daily—to on-line, real-time processing. It expects all locations to be converted by mid-2009. During this transition, if a debit card overdraft is inadvertently paid, SHCU does not charge the customer a fee for covering the payment.

SHCU customers can apply for an overdraft line of credit of up to $500, carrying an interest rate of 16 percent. Customers may also link their checking account to their savings account, and SHCU charges a $1 fee for each transfer from savings to checking. To avoid encouraging customers to purposefully use this overdraft coverage for short-term cash shortfalls, SHCU only allows customers' accounts to be overdrawn by checks and ACH transactions, and not by point-of-sale or ATM transactions.

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[1] SHCU merged with Wilson Community Credit Union and Scotland Community Credit Union in 2004 and with Cape Fear Community Credit Union in 2006.

[2] These include traditional savings accounts, money market accounts, certificates of deposits, and individual retirement accounts.

INTRODUCTION

We thank the Federal Reserve Board (the Board), the Office of Thrift Supervision (the OTS), and NCUA (collectively, the Agencies) for focusing their efforts on abusive overdraft practices in their Proposed Rule on Unfair or Deceptive Acts or Practices (the Proposed Rule).[3] We particularly commend the Agencies for proposing a rule that would apply to all types of transactions. Many of our nation's financial institutions are betraying the trust of their account holders by quietly replacing what was once an occasional accommodation with a system of high-cost, unsolicited overdraft loans that drive their account holders further into debt. Marketed as "overdraft protection," abusive overdraft lending protects only the banks' ability to maximize fees while jeopardizing the financial stability of many of their customers. Rather than competing by offering lower cost, truly beneficial overdraft products and services, many financial institutions use misleading terms and opaque practices to lead borrowers to overdraw their accounts repeatedly and incur costly overdraft fees.

Industry has ignored nearly every key best practice on overdraft operations that the Agencies recommended over three years ago,[4] making it clear that further reform is necessary.

- The Agencies recommended obtaining account holders' affirmative consent before enrolling them in fee-based overdraft programs, but institutions continue to place account holders in the abusive programs automatically when they open their checking account.
- The Agencies recommended alerting account holders before a transaction triggers a fee, but institutions continue to routinely approve debit point-of-sale and ATM transactions when an overdraft will result, without warning the account holder or asking permission to make the loan.
- The Agencies recommended establishing daily limits on overdraft fees, yet, to the extent institutions have set limits at all, they typically set them unreasonably high and still allow an account holder to be charged hundreds of dollars of fees in a single day.
- The Agencies recommended that institutions consider limiting overdraft programs to check transactions only, but institutions continue to apply their overdraft programs to all transaction types, including debit card transactions.
- The Agencies recommended monitoring excessive use, but institutions' practices indicate that they invite excessive use more than they monitor it.

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[3] 73 Fed. Reg. 28904 (May 19, 2008).

[4] Department of the Treasury—Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, NCUA, Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127, 9131-32 (Feb. 24, 2005) [hereinafter Joint Guidance]; Department of the Treasury—Office of Thrift Supervision, Guidance on Overdraft Protection Programs, 73 Fed. Reg. 8428, 8430-31 (Feb. 18, 2005) [hereinafter OTS Guidance].

- The OTS cautioned against manipulating the order in which transactions are cleared to maximize overdraft fees. Yet institutions continue posting transactions in order from highest to lowest and posting debits as quickly as possible, while delaying for as long as possible making deposits available for use.

Their incentive? Abusive loans earn them $17.5 billion in revenue each year—almost $2 billion more than institutions extend in the overdraft loans that trigger the fees and close to half the total service charge revenue institutions collected in 2007. Overdraft loans have been the industry's single most profitable product behind residential mortgages.

Abusive overdraft loans are costly for everyone but are most destructive to people who are struggling to meet their financial obligations. For example, CRL recently found that seniors who depend primarily on Social Security income to cover living expenses pay over $1 billion in overdraft fees each year.[5] In a system hugely out of balance, too many of our banks and credit unions are collecting enormous fees from people who have nothing to spare, making them even less able to meet basic obligations.

As the average overdraft fee continues to increase, along with the number of times per day account holders can be charged a fee, and as debit card transactions become increasingly common, the trend is toward more abuse, not less. This trend will no doubt continue absent stronger action than proposed by the Agencies.

The Agencies' proposal to find that providing an overdraft loan and charging a costly fee without allowing a reasonable opportunity to opt out is an unfair practice is a partial step in the right direction. Unfortunately, though, it will not substantially reduce pervasive abusive overdraft practices. Account holders would continue to be enrolled automatically in the most expensive overdraft option that their bank or credit union offers and to be burdened with unenrolling if they don't want to participate. The rule would continue to allow most of the practices the Agencies cautioned against three years ago.[6] And an opt-out regime could even make the current situation worse—it could create the impression that account holders have been given a fair choice about overdraft, when in reality there is little possibility that account holders will receive a meaningful opportunity to get out of these abusive and expensive programs.

Any rule on overdraft must, at a minimum, require institutions to obtain account holders' consent by affording them the opportunity to make an affirmative choice among overdraft alternatives,

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[5] *See* Leslie Parrish and Peter Smith, *Shredded Security: Overdraft practices drain fees from older Americans*, Center for Responsible Lending (June 18, 2008), *available at* http://www.responsiblelending.org/pdfs/shredded-security.pdf (last visited July 17, 2008) [hereinafter *Shredded Security*]. *See also* further discussion in Section II.A.2.c.

[6] The Proposed Rule is also dramatically weaker than the pending bill in Congress addressing overdraft practices, H.R. 946. The bill would require specific written consent for account holders to be charged more than three overdraft fees in one year; would clarify that overdrafts are extensions of credit requiring TILA and Regulation Z disclosures; would require that customers be warned and allowed to cancel the transaction before incurring overdrafts through an ATM or point-of-sale transaction; and would immediately prohibit manipulating the clearing of transactions to create overdraft. H.R. 946, Consumer Overdraft Fair Practices Protection Act, 110th Session, *available at* http://www.govtrack.us/congress/bill.xpd?bill=h110-946 (last visited July 23, 2008).

including no overdraft coverage at all. The following key points, which we develop in Section II.A of these comments, support the position that only an opt-in requirement has the potential to adequately protect account holders:

- The default arrangement is critical because a wide range of evidence suggests that the vast majority of account holders will not alter the initial default status of the account.

- Fee-based overdraft causes account holders more harm than benefit, both in the aggregate and in the large majority of overdraft transactions. Most overdraft fees are paid by repeat overdrafters, those least able to recover from the abusive fees. Even in those few instances where account holders benefit from having one particular transaction covered, fee-based overdraft ultimately prevents them from being able to pay obligations they otherwise would have been able to pay and leaves them worse off than they would have been with no overdraft coverage at all.

- Account holders overwhelmingly want a choice about overdraft, and they clearly don't want overdrafts covered when they could be easily avoided for no fee.

Since the default will determine the arrangement for the vast majority of account holders, it is critical that the Agencies get the default right. In a minority of circumstances, fee-based overdraft coverage may provide account holder benefit because the consequence of having a transaction denied could be significant. But, as we discuss in Section II.A, transactions that carry significant consequences when denied account are the small minority of transactions. Even if an account holder may benefit from fee-based overdraft coverage in the context of a single transaction, the Agencies must weigh this benefit against the greater harm to the account holder both by being continually enrolled in the program and by being charged a fee every time that denying a transaction would cause no harm. Moreover, the potential consequences of denial are not common or substantial enough to warrant having an entire regulation designed to prevent them, *especially when the consequence of doing so is to allow common, rampant, and severely harmful financial abuse to continue unfettered in the large majority of circumstances.*

The Agencies' own findings in their UDAP analysis make clear that fee-based overdrafts can cause substantial costs. The Agencies' discussion of the benefits of fee-based overdraft, on the other hand, is not extensive. In the proposal, the purported benefits claimed by industry are simply noted, but the Agencies provide little-to-no empirical evidence or substantive arguments to support these purported benefits.[7] The proposed solution to the problem of costly overdraft loan programs, however, is to set the default at automatic enrollment in the program, with the only chance for escape resting on the effectiveness of an opt-out disclosure. We urge the Agencies to prescribe a far better solution to the problem they have already diagnosed by issuing a final rule more consistent with their own findings. The final rule should address the abuse that occurs in the vast majority of circumstances by requiring institutions to obtain account holders' affirmative consent to fee-based overdrafts.

[7] 73 Fed. Reg. 28929.

In Part I of these comments, we urge the Agencies to subject overdraft loans to Regulation Z under TILA and to adopt substantive reform by limiting the number of overdraft fees that may be charged in a prescribed period.

In Part II, we address the Agencies' opt-out proposal. We begin in Section A by developing three critical points that together show that an opt-in arrangement is the only one that can hope to adequately protect account holders: (1) the default arrangement is critical because account holders are unlikely to alter it; (2) fee-based overdraft causes account holders more harm than good—both in the aggregate and in the vast majority of transactions; and (3) account holders overwhelmingly want a choice about overdraft, and they overwhelmingly don't want transactions covered when they could easily be denied for no fee. Therefore, the default arrangement should be no fee-based coverage with an opportunity to opt in.

We continue in Part II, Section B, by applying the three-pronged UDAP analysis to the practice of automatically enrolling account holders in a fee-based overdraft program. We find that automatic enrollment causes substantial injury; that the injury cannot be reasonably avoided by the account holder because the account holder's ability to avoid it rests entirely on disclosure; and that there are no countervailing benefits to consumers or competition.

In the remainder of Part II, we explain why industry defenses of fee-based overdraft are not adequate reasons to allow unauthorized overdraft fees (Section C); we recommend alternatives, more protective than opt-out, in the event the Agencies do not require opt-in (Section D); we discuss why the Agencies' alternative suggestion of partial opt-out will not adequately protect account holders (Section E); and we make several recommendations on the Agencies' opt-out rule in they event they adopt that proposal (Section F).

In Part III, we discuss our support for the Agencies' proposal to eliminate overdraft practices caused solely by debit holds. We also urge the Agencies to adopt a rule prohibiting overdrafts caused solely by deposits not yet posted to account holders' accounts, when those deposits have already been received by the institution.

In Part IV, we urge the Agencies to immediately prohibit manipulative clearing practices.

Finally, in Part V, we encourage the Agencies to require that their final rules be implemented as soon reasonably practicable because the injury caused in the interim will be immense.

Summary of Recommendations:

Our recommendations aim to address the Agencies' Proposed Rule while highlighting three central problems with fee-based overdraft loans: (i) institutions are not required to provide with any ***clarity*** the terms under which they are extended; (ii) institutions are not required to obtain account holders' ***consent*** before extending them; and (iii) institutions maximize their ***cost*** to account holders by employing an array of unfair trade practices. Our recommendations are as follows:

- Subject fee-based overdraft loans to Regulation Z requirements under the Truth in Lending Act (TILA) (Section I.A).

- Limit the number of overdraft fees that may be charged to four per year or, alternatively, one within a 60-day period (Section I.B).

- Require institutions to obtain account holders' affirmative opt-in before enrolling them in fee-based overdraft programs (Section II.A). In the alternative, at a minimum, require affirmative opt-in for debit point-of-sale and ATM transactions (Section II.D). At the very least, do not weaken the current proposal by only providing account holders a partial opportunity to opt out (Section II.E).

- In the event the Agencies retain their proposed opt-out rule, they should (Section II.F):

  - Clarify that the rule applies to existing account holders;

  - Allow no exceptions;

  - Provide a maximum number of days institutions have to comply with account holders' opt-out requests; and

- We applaud the Agencies' proposal to prohibit overdraft fees for overdrafts caused solely by debit holds. We urge them to retain this proposal and extend it to overdrafts caused solely by deposits already received by the institution but not yet posted to the account holder's account (Part III).

- Immediately prohibit manipulative clearing practices that maximize overdraft fees (Part IV).

In CRL's 2008 Comments on Regulation DD, we provided a sample opt-in form (CRL's Opt-in Notice) and asked the Board to use it, or some variation of it, in its consumer testing.[8] We attach the form to these comments as well (Appendix A). The form is designed to allow account holders to select the option that best meets their needs: (1) to transfer funds from another account; (2) to apply for a personal line of credit; (3) to transfer funds from a credit card; (4) to use the overdraft program to pay the item; or (5) to decline to have the overdraft covered. It also allows account holders to choose to have checks and electronic transfers handled differently than debit and ATM transactions.

[8] Comments of the Center for Responsible Lending, along with Consumer Federation of America, Consumers Union and National Consumer Law Center, to Board of Governors of the Federal Reserve System on proposed amendments to Regulation DD, promulgated pursuant to the Truth in Savings Act, Docket No. R-1315 [hereinafter 2008 Proposed Rule to amend Regulation DD], Section III, pp. 25-26 (July 18, 2008) [hereinafter CRL's 2008 Comments on Regulation DD], *available at* http://www.responsiblelending.org/pdfs/crl-reg-dd-comments-071808-w-appendices-as-submitted.pdf (last visited Aug. 1, 2008).

This sample form has not had the benefit of consumer testing. We may continue to tweak it as we think about ways it could be made more effective, and we invite the Agencies to do the same.

I. <u>SUBSTANTIVE REFORM</u>

Requiring account holders' affirmative consent before extending them credit for a fee would significantly improve the Agencies' opt-out proposal. However, the Agencies should also close the loophole that exempts overdraft loans from Regulation Z requirements under TILA.

Substantive reform is the only way to fully eliminate abusive overdraft lending. Systematically stripping customers' accounts of funds through excessive overdraft fees is an unfair practice, whether or not account holders have the opportunity to opt out *or* opt in. Even under an opt-in arrangement, the financial incentive for institutions to maximize fees would remain strong, and employees would likely steer new account holders into fee-based overdraft. Moreover, disclosures are voluminous and confusing to the average account holder, so many customers may opt in to the program without understanding the risks involved. For that reason, we begin our comments with additional protections that the Agencies should adopt to curb this unfair practice.

A. Overdraft loans should be subject to TILA requirements.

The Board has explicitly acknowledged that overdraft loans are an extension of credit.[9] Overdrafts are rarely extended on an ad-hoc basis as they once were; rather, as the Board appears to acknowledge, covering overdrafts has become the rule instead of the exception.[10] As long as the Board continues to exempt overdraft loans from Regulation Z, it condones and perpetuates misleading disclosures about overdraft coverage, which, as we noted in our 2008 Comments on Regulation DD, are reflected even in the Board's Sample Opt-Out Notice. Please see CRL's 2004 Comments on the Board's prior proposed amendments to Regulation DD for a complete discussion of why overdraft loans should be subject to TILA.[11]

Notably, in its current proposed rules to amend Regulation Z,[12] the Board retained its proposal to require pre-account opening disclosures for open-end loan products, including "traditional overdraft credit plans." In its discussion, the Board notes that it "continues to believe that even

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9 Joint Guidance, 70 Fed 9129: "When overdrafts are paid, credit is extended."

10 "Over the years, most institutions have largely automated the overdraft process . . . ." 73 Fed. Reg. 28927; "Coverage is 'automatic' for consumers who meet the institution's criteria. . . ." 73 Fed. Reg. 28928.

11 Comments of the Center for Responsible Lending to the Board of Governors of the Federal Reserve System on proposed amendments to Regulation DD, promulgated pursuant to the Truth in Savings Act; and the Proposed Interagency Guidance on overdraft loan programs issued by the Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, OTS, and NCUA, Docket No. R-1197 and Docket No. OP-1198, Part II.B (Aug. 6, 2004) [hereinafter CRL's 2004 Comments], *available at* http://www.responsiblelending.org/pdfs/Comment-FedFDIC-OverdraftTILA.pdf (last visited Aug. 1, 2008).

12 Federal Reserve System's Proposed Rules to Amend Regulation Z, Truth in Lending, Docket No. R-1286, 73 Fed. Reg. 28866.

for non-credit card accounts the benefit to consumers from receiving a concise summary of rates and important fees appears to outweigh the costs."[13]

The Board clearly recognizes the importance of requiring appropriate disclosures for a reasonably priced form of overdraft credit. Fee-based overdraft loans, however, are the *most common* and the *most expensive* form of overdraft credit available. Should the Board adopt the sample tabular disclosure of the line of credit terms it proposes in its proposed rules,[14] account holders are even more likely to mistakenly believe the line of credit—with its formal, tabular disclosure —is more expensive than the exorbitant fee-based program, with no cost of credit disclosure at all. The solution is to offer account holders the clarity they deserve about this expensive loan product by subjecting fee-based overdraft to the same disclosure requirements as the overdraft line of credit.

B. The Agencies should limit the number of overdraft fees to four per year or, alternatively, to one within a 60-day period.

Overdraft fees are too costly. The 2005 Joint Guidance recommended that institutions consider establishing daily limits on the number of overdraft fees charged.[15] Yet given the incentive institutions have to maximize fees, it's no surprise that this best practice has not been adopted in a way that significantly reduces costly overdraft fees. The large institutions that do have caps have set them unreasonably high—at seven per day, for example, totaling $245 in fees charged in a single day.[16] The only way regulators will convince institutions to establish reasonable daily fee limits is to prescribe a reasonable cap.

As we recommended in our 2004 Comments, the Agencies should find it an unfair practice to charge more than four overdraft fees per year or, alternatively, more than one overdraft fee within a 60-day period.[17] If account holders are overdrawing any more often, we can assume they are caught in a debt trap. At that point, it is unfair to make it impossible for them to escape the trap—which the overdraft system may have created in the first place—by charging them an exorbitant overdraft fee for every transaction that further overdraws their account. Please *see* our 2004 Comments for further discussion.

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[13] *Id.* at 28876.

[14] *Id.* at 28894 – G-17(D) Account-opening Sample (Line of Credit).

[15] Joint Guidance, 70 Fed. Reg. 9132.

[16] Washington Mutual and Bank of America both limit the number of overdrafts a customer may be charged each day to seven. At $35 each, the daily cap computes to $245, excluding any additional daily negative balance fees that may also be charged. WaMu, Our Fees and Frees, *available at* http://www.wamu.com/NR/rdonlyres/E58D9C54-1024-49DE-878A-661CC5518942/0/OurFeesandFrees_060108.pdf (last visited June 26, 2008); Bank of America's My AccessChecking Account disclosure of fees, *available at* http://www.bankofamerica.com/deposits/checksave/index.cfm?template=check_myaccess (last visited June 26, 2008).

[17] CRL's 2004 Comments, *supra* note 11, at 14-15.

The Agencies should also find it an unfair practice to charge more than one overdraft fee per overdraft incident. Consecutive overdrafts should be grouped as a single overdraft incident because one oversight, such as a missed deposit, can cause multiple overdrafts within a short time frame before the customer realizes the overdraft has occurred. Because cascading fees can amount to *hundreds of dollars per day*,[18] they clearly cause substantial injury. Because they happen one right after the other, they are not reasonably avoidable by the account holder. There is no legal duty for institutions to immediately notify account holders that they have overdrawn their account. As a result, by the time account holders learn about the overdraft, it is too late to avoid the associated fees.

If the Agencies do not establish a cap at this time, we ask that they keep the docket open so that this record may be used to support a cap at a later date.

II. OPT-OUT REQUIREMENT[19]

A basic principle of contract that underlies products such as overdraft loans is *consent*. We have been hard-pressed to come up with another example of a loan where the borrower does not request credit from a financial institution before it is provided. A recent CRL survey indicates that an overwhelming percentage of account holders want the option to choose whether or not an overdraft loan program is included with their account.[20] The Agencies' proposal would provide account holders more input than they have now—so long as they understand they have an opportunity to opt out and take action to do so. As we discuss throughout this Part II, however, research shows that both of these conditions are unlikely, leaving ample room for the existing abuses to continue unfettered. In Section B, we explain that automatically enrolling account holders in the most expensive overdraft programs available without their consent—which would be permitted under the Proposed Rule—is the unfair practice that the Agencies should proscribe.

The Agencies have the authority to address and proscribe unfair or deceptive acts or practices under the Federal Trade Commission Act (FTC Act) and, in so doing, may consider public policy.[21] We begin in Section A by laying out the key underlying points that establish why—in the interest of both the Agencies' responsibilities to protect account holders from unfair practices and broader public policy—the only justifiable default is no fee-based overdraft.

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[18] *See*, *supra*, note 16.

[19] 73 Fed. Reg. 28929, __.32(a)(1).

[20] Eighty-eight percent of account holders want a choice about whether overdraft is included with their checking account. Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options*, CRL Research Brief (Apr. 16, 2008), *available at* http://www.responsiblelending.org/pdfs/final-caravan-survey-4-16-08.pdf [hereinafter CRL Research Brief].

[21] 73 Fed. Reg. 28907, citing Federal Trade Commission Act, §18(f)(1) (15 USC 57a(f)(1)).

A. The Default Arrangement Should Be the One that Benefits Account Holders More Than It Harms Them and Better Reflects Account holder Preferences.

In this section, we discuss the following key underlying points:

- **The default status of an account and related overdraft programs is critical because a wide range of behavioral research indicates that people are unlikely to alter the default arrangement. Since the default will determine how overdrafts are handled for the vast majority of account holders, it should be the arrangement that benefits account holders more than it harms them and better reflects their preferences (*see* subsection 1).**

- **The harm to account holders from fee-based overdraft programs vastly outweighs the benefits, both in the aggregate and in the large majority of transactions. Most overdraft fees are paid by repeat overdrafters, least able to recover from them. Even if these account holders benefit from having one particular transaction covered, fee-based overdraft ultimately prevents the account holder from being able to pay obligations they otherwise would have been able to pay—and leaves them worse off than they would have been with no overdraft coverage at all (*see* subsection 2).**

- **Stated account holder preferences clearly indicate that they want a choice about overdraft and that they don't want overdrafts covered when they could easily be denied for no fee (*see* subsection 3).**

The only reasonable conclusion that can be drawn from these points is that the default arrangement should be no fee-based overdraft, while allowing account holders the choice to opt in.

1. The default rule is critical because account holders are highly likely to stick with it.

There is substantial empirical evidence that suggests that the vast majority of account holders will not alter the default status of their account set by the Agencies, even when the default does not reflect either their personal preferences or what a rational actor would choose. Therefore, a proposal that sets the default wrong, as the Agencies' proposal does, will not protect the vast majority of account holders who will not change the default, nor will it curb abusive overdraft practices.

A number of studies in a wide range of contexts have shown that people do not tend to change default arrangements.[22] This "status quo" bias occurs even when choosing to alter the default is

[22] *See, e.g.*, Brigitte C. Madrian and Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q J Econ 1149, 1149-50 (2001). The authors studied participation levels in the 401(k) plan of a large U.S. corporation before and after the company changed its enrollment policy from standard enrollment (employees are only enrolled if they affirmatively choose to be) to automatic enrollment (all new hires are automatically enrolled in the plan unless they opt out, with no effect on already-hired employees). Under standard enrollment, employees' enrollment in the plan was strongly correlated to their tenure at the organization, with those

the rational choice. A wide range of factors can reduce the likelihood of people choosing what may be in their best interest. First, the power of inertia cannot be underestimated.[23] Second, unfamiliarity with a complicated situation may cause people to develop ill-formed preferences.[24] Third, the way a choice is framed has enormous potential to sway people.[25] Even the default rule itself may influence people's view of what the best choice is, as many individuals may assume a

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at the company 20 years or longer having the highest participation rates. Fifteen months following the change in policy, enrollment of employees hired since the change was 86 percent—versus 49 percent of the employees hired during the year before the change, and even higher than the 83 percent of employees with tenure of 20 years or longer who were enrolled. *See also* John Beshears et. al., *The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States* (Mar. 2007) *available at* http://www.people.fas.harvard.edu/~beshears/papers/simplification_and_saving.pdf (last visited Aug. 1, 2008) (noting consistent findings in the context of another company's change from standard to automatic enrollment).

In the context of insurance, two states introduced the option of a limited right to sue which, if chosen, entitled the driver to lower interest rates. In one state, full right to sue was the default, and consumers had to affirmatively opt for the limited right to sue. Only approximately 25 percent of drivers did so, so 75 percent retained full right to sue. In the other state, limited right to sue was made the default, and consumers had to affirmatively opt out to retain full right to sue. Only approximately 20 percent acted to retain full right to sue, so 80 percent of drivers ended up with limited right so sue. The difference in adoption rates had financial repercussions estimated at nearly $200 million. Cass R. Sunstein and Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. Chi. L. Rev. 1159, 1172-73 (Fall 2003) (Johnson, E.J. et. al., *Framing, Probability, and Insurance Decisions*, Journal of Risk and Uncertainty, 7, 35-51 (1993), *available at* http://www.springerlake.com/content/x535827t2m525776/fulltext.pdf (last visited Aug. 1, 2008).

In the context of organ donation, nations where individuals are presumed to consent to having their organs donated unless they opt out have a donation rate of 90 percent. In the United States, where people must affirmatively opt to donate their organs, the rate is only 28 percent. Yet by at least one report, over 85 percent of Americans support organ donation, which suggests that few Americans would opt out of a presumed consent arrangement. Sunstein, *Id*., at 1191-92 (citing http://www.presumedconsent.org/solutions.htm (last visited July 23, 2008) (reporting the opt-out rates in presumed consent countries)); Jean Kadooka Mardfin, Heart and Soul: Anatomical Gifts for Hawaii's Transplant Community 5, Hawaii Legislative Bureau Report No 3 (1998), *available at* http://www.state.hi.us/lrb/rpts98/soul.pdf (visited July 23, 2008) (reporting results of a 1993 Gallup poll that asked Americans whether they had "granted permission for organ donation on their driver's license or on a signed donor card.").

[23] *See*, *e.g.*, Madrian and Shea, *supra* note 22, at 1177 (noting that transaction costs, even when small, can lead individuals to delay changing the default); Sunstein, *Id.*, (providing the example that many individuals wait until the last minute to file their tax return, even when they are assured of getting a refund) *Id.* at 1181.

[24] *See*, *e.g.*, Madrian and Shea, *Id.*, at 1180 (noting that complexity involved in 401(k) selections may lead employees to reasonably simplify the set of choices available by ignoring some options altogether, but they likely won't disregard the default since it may be the only option with which they have any experience) (citing Samuelson, William, and Richard Zechhauser, *Status Quo Bias in Decision Making*, Journal of Risk and Uncertainty, I (1988), 7-59)).

[25] For example, studies have found that people avoid extremes. In one study involving asset allocation choices in defined contribution plans, people tended to select the middle portfolio when offered three options and allocate their savings across all the portfolios they were offered. Peter Kooreman and Henriete Prast, *What Does Behavioral Economics Mean for Policy? Challenges to Savings and Health Policies in the Netherlands* at 15, Paper prepared for the Netspar Panel on April 26, 2007 (Apr. 12, 2007), *available at* http://home.orange.nl/peterkooreman/pibe.pdf (last visited July 22, 2008) (citing Benartzi and Thaler). Decisions, including willingness to take risks, also vary depending on whether the options are posed in terms of losses or gains, even though they may, in reality, be identical scenarios. *Id.* at 14.

default was designed that way because it's what most people do, or what most informed people do, or is what's best for them.[26]

Scholars have noted at least two approaches policymakers can take when designing a default. One is to conduct a cost-benefit analysis that focuses on welfare effects, while another is to set the default as whatever policymakers believe the majority would choose if their preferences were explicit.[27] In the context of overdrafts, as we explain in subsection 2, a cost-benefit analysis shows that fee-based overdrafts cause account holders more harm than good. With respect to majority preference, as we explain in subsection 3, CRL surveys show that the overwhelming majority of account holders would rather not have their overdrafts covered when they could be easily denied for no fee, which is the case with the most common trigger of overdrafts, debit transactions. Both approaches then suggest that the Agencies should set the default at no fee-based overdraft coverage.

2. <u>The harm to account holders from fee-based overdraft outweighs its benefits, both in the aggregate and in the large majority of transactions</u>.

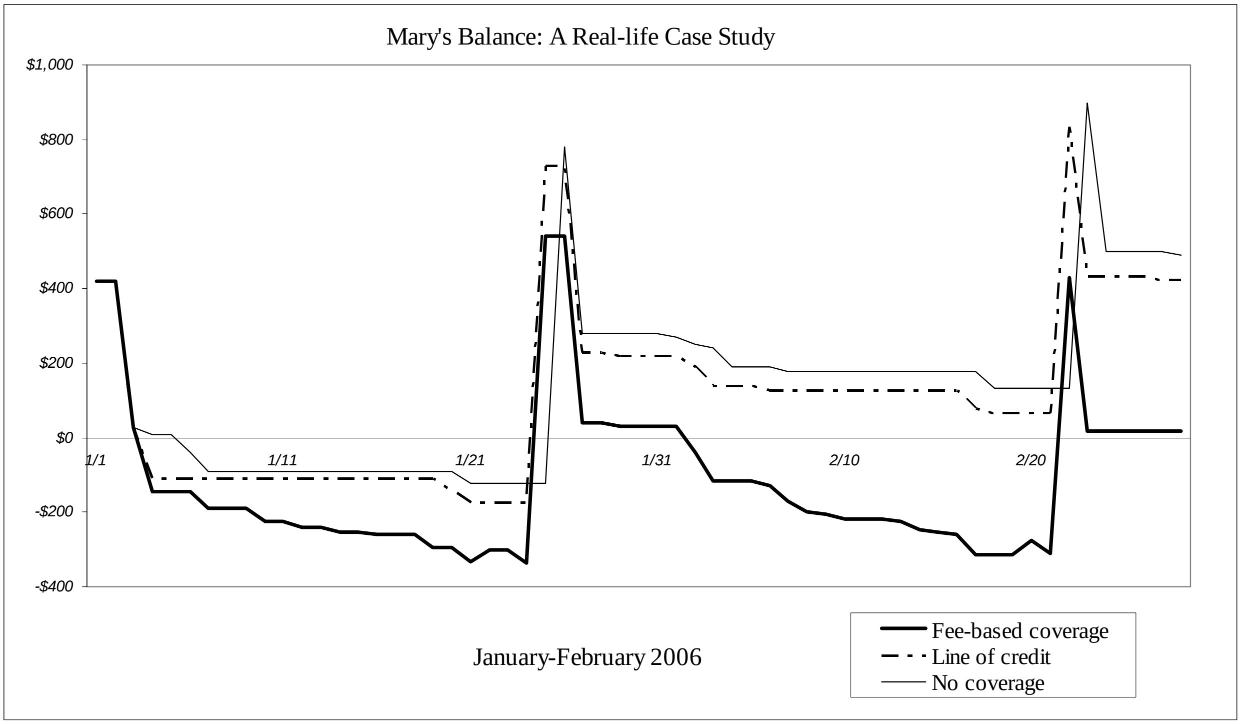
In the Proposed Rule, the Agencies themselves acknowledge that fee-based overdraft programs can cause substantial harm to account holders.[28] In fact, the harm of these programs dramatically outweighs their potential benefits. First, the overall cost of overdraft actually exceeds the dollar value of the loans extended. Second, overdraft coverage of debit transactions, the most frequent trigger of overdrafts, causes tremendous harm while offering no benefit, because the cost of a denied transaction is zero. Third, the large majority of fees are paid by repeat overdrafters, who are also those least able to recover from them. Fourth, and critically, as the following real-life case study demonstrates, fee-based overdraft leaves these account holders worse off than cheaper overdraft alternatives *or no overdraft coverage at all*.

In our recent report on the impact of overdraft fees on older Americans, we graphed two months of actual checking account activity of one panelist from our database, whom we call Mary. Mary is an older American entirely dependent on Social Security for her income. We also graphed what her activity would have been with an overdraft line of credit. The two relevant pages from our report, including the graph, are attached to these comments as Appendix B. We later added a third scenario to the graph: no fee-based coverage at all, reflected in the graph on the following page:

[26] *See, e.g.*, Beshears, et. al., *supra* note 22 (describing the "endorsement effect"—individuals perceiving the default as an endorsement of a particular course of action—and noting that, under automatic enrollment, employees' asset allocations in their retirement plans remain heavily influenced by the default in place when they were enrolled even after a substantial period of time); *see also* Sunstein, *supra* note 22, at 1180-81.

[27] Sunstein, *supra* note 22, at 1194.

[28] 73 Fed. Reg. 28929.



During January and February of 2006, Mary overdrew her account several times and was charged $448 in overdraft fees. At the end of February, she had $18.48 in her account. She was trapped in a destructive cycle, using the bulk of her monthly income to repay costly overdraft fees.

With an overdraft line of credit at 18 percent, after two months, Mary would have paid about $1 in total fees for her overdrafts and would have had $420 in the bank.[29]

Critically, *even if Mary had had no overdraft coverage at all*, she would have been better off than she was with fee-based overdraft. Five of her transactions, totaling $242, would have been denied—two point-of-sale transactions and three electronic transactions. She would have been charged no fee for the two point-of-sale transactions. She may or may not have been charged an NSF fee for each of the three denied electronic transactions. She also may have been charged late fees if any of the electronic transactions were bills. Assuming, conservatively, that she was charged an NSF fee and a late fee for each of the three transactions, as the chart illustrates, her ending balance still would have been $489—plenty enough to cover the value of the denied transactions.

Industry's common defense of fee-based overdraft is that it protects account holders from having important payments, like utility bills, bounce. But with fee-based coverage, Mary's utility payments in both January and February were denied *anyway* because she had already overdrawn her account by more than $300 each time—*largely due to overdraft fees*. With no overdraft coverage at all, while her January utility payment would have been denied, she would have had

[29] *Shredded Security*, *supra* note 5, at 9-10.

the money to pay her entire outstanding utility balance in February.

Mary's case demonstrates that while struggling account holders with no overdraft coverage may pay some bills late, they are still better able to pay bills eventually than they would be with fee-based coverage. And late fees they may incur from routine vendors, like utility and phone companies, do not have significant consequences so long as the bills due not remain unpaid for a substantial period of time. Typically, then, the potential consequences of late fees are rarely as destructive as the repeat overdraft fees charged to those who pay the majority of these fees.

In addition, Mary's situation illustrates a problem common among the repeat overdrafters who pay the vast majority of the fees: Overdraft fees simply beget more overdraft fees. Not only is there no benefit to the account holder from covering certain types of transactions (debit point-of-sale and ATM), but even when there may be benefit from having a single transaction covered, the Agencies must balance this benefit against the subsequent costs to account holders beyond that one transaction—specifically against the increased likelihood that the account holder will pay additional overdraft fees for transactions that carry no cost when denied, and be unable to meet future obligations.

Ultimately, fee-based overdraft coverage prevents account holders from being able to meet obligations they otherwise would have been able to meet. This reality makes it impossible to justify fee-based overdraft as a program that causes account holders more benefit than harm.

a. The cost of overdraft fees exceeds the benefit, in the aggregate and in the majority of transactions.

The cost of fee-based overdraft programs is simply astronomical, while the benefit is largely determined by the costs account holders avoid by having their transactions covered instead of denied. Having a debit card denied results in no cost at all. Coverage of checks, however, may provide the benefit of avoiding a merchant fee, when such a fee is charged, and coverage of checks and electronic transactions may prevent late fees for denied bill payments. The transactions where fee-based overdraft may benefit the account holder should not drive the rule, however, because (i) they are the very small minority of transactions; and (ii) even if, in the context of a single transaction, coverage benefits the account holder, enrollment in the program likely nonetheless causes that customer more harm than benefit when all the customer's transactions are taken as a whole.

(i) *Cost*.

The $17.5 billion account holders are charged by fee-based overdraft programs each year exceeds the $15.8 billion institutions extend in credit for the related overdrafts.[30] These figures

[30] Eric Halperin and Peter Smith, *Out of Balance: Consumers pay $17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending (June 2007), *available at* http://www.responsiblelending.org/issues/overdraft/reports/page.jsp?itemID=33341925 (last visited July 9, 2008) [hereinafter *Out of Balance*]. CRL analyzed 18 months of bank account transactions from participants in Lightspeed Research's Ultimate Consumer Panel, from January 2005 to June 2006. For further discussion of our database and methodology, *see Out of Balance* at 13-14.

translate to a cost of $1.11 in fees for every $1.00 in loans—clearly an exorbitant price for credit.[31] Moreover, these loans are paid back immediately upon the customer's next deposit—on average, within five days or less.[32] This extremely short loan term makes the already excessive cost even more disproportionate to the "service" being provided.

The average overdraft fee account holders pay is $34, both in the aggregate and for each category of transactions, including debit cards, checks, and electronic transactions. Regardless of the type of transaction, the cost of the loan relative to its size is outrageously high. For debit cards, the most common trigger of overdraft fees, the average fee is double the average overdraft loan amount (*see* subsection b below for further discussion of debit cards). For electronic transactions, which trigger 28 percent of all overdrafts, the average loan amount is only $28[33]—also smaller than the average fee. The size of overdrafts triggered by checks, which cause only 27 percent of all overdrafts,[34] is also relatively small. The average check purchase that triggers an overdraft is only $60, causing an overdraft of only $41, but again incurring an average fee of $34.[35]

(ii) <u>*Benefit.*</u>

An assessment of the benefit of fee-based overdraft programs requires an analysis of what an account holder is gaining by *not* having a transaction denied – i.e., the cost of denied transactions. Debit transactions clearly carry no cost when denied. Our research, described in the following two paragraphs, found that denial of the vast majority of non-debit transactions does not result in significant consequences, either.[36] By significant consequences, we mean a

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[31] Due to the loophole in Regulation Z, overdraft loans have been exempted from required annual percentage rate (APR) disclosures. But the typical overdraft (a $27 overdraft, triggering a $34 fee, repaid five days later) would carry an APR of over 16,000 percent. Even if the loan weren't repaid for two weeks, the APR would still be over 5,000 percent. The contrast in the cost of fee-based overdraft versus an overdraft line of credit is stark: assuming an APR of 18 percent, a $20 overdraft not repaid for an entire month would cost the account holder about 30 cents.

[32] Eric Halperin, Lisa James, and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending, at 25 (Jan. 25, 2007), *available at* http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf (last visited July 15, 2008) [hereinafter *Debit Card Danger*].

[33] The average electronic transaction triggering an overdraft is $29; the average overdraft amount is $28; the average fee: $34. *Id.*

[34] This percentage is shrinking as usage of debit cards climbs. *Debit Card Danger*, *supra* note 32, at 25. In 2003, the number of electronic payments and check payments was roughly equal. Three years later, more than two-thirds of all noncash payments were made electronically, and the most common of those electronic payments were debit card transactions. Debit card transactions are increasing at a rate of 17.5 percent per year, while check payments are decreasing 6.4 percent annually. 2007 Federal Reserve Payments Study, Financial Services Policy Committee, *Federal Reserve Study Shows That More Than Two-Thirds of Noncash Payments Are Now Electronic* (Dec. 10, 2007), *available at* http://www.federalreserve.gov/newsevents/press/other/20071210a.htm (last visited July 9, 2008).

[35] *Debit Card Danger*, *Id.*, at 25.

[36] Non-debit transactions consist of ACH transactions, including electronic bill pay and other electronic transfers, and checks.

cost greater than a merchant fee and a late fee, such as an increase in the cost of an account holder's credit.

In order to estimate the percentage of non-debit transactions that could potentially result in a significant consequence if denied, we analyzed a sample of electronic, non-debit overdraft transactions in our database.[37] We found that only an estimated 24 percent of these electronic transactions could have potentially carried a significant consequence if denied—the mortgage, credit card, and student loan payments. Denial of over three-fourths of the transactions, then, would not have resulted in significant consequences. Since electronic transactions account for 28 percent of all overdraft transactions, the electronic transactions that could potentially carry significant consequences if denied account for an estimated 7 percent of all overdraft transactions.

While we were unable to perform a similar analysis of the checks in our database because payee information was not available, we know of no empirical evidence suggesting that an analysis of check transactions would result in significantly different findings than our analysis of electronic transactions. As checks account for 27 percent of all overdraft transactions, the checks that could potentially carry significant consequences if denied account for an estimated 6 percent of all overdraft transactions—bringing the total number of *all* overdraft transactions that could *potentially* have a significant consequence when denied to only 13 percent.

As we noted in our introduction, the default should be designed to address the majority of transactions. The above research indicates that even of those transaction types that *may* carry a consequence when denied, only a small portion of them actually do. Further, even if in a small minority of transactions, fee-based overdraft coverage may benefit the account holder in the context of a single transaction, beyond the context of that transaction, it doesn't benefit those who pay the vast majority of overdraft fees. First, by being enrolled in the program, they would also be subjected to overdraft fees for those transactions that carry no significant consequence when denied. Second, coverage of any type of overdraft transaction drives account holders into debt—a debt that will be taken from the customer's next deposit, regardless of whether the customer would have chosen to pay that debt before other expenses. Considered as a whole, then, enrollment in fee-based overdraft programs clearly causes account holders far more harm than benefit.

b. Overdraft fees for debit transactions cause tremendous harm while offering no benefit.

Debit card transactions, which are usually far smaller than the average overdraft fee, are the most common trigger of overdrafts. This is true not only for young adults, who we would expect to be frequent debit card users,[38] but also for Americans aged 55 and over.[39]

[37] *See*, *supra*, note 30 for discussion of our database. This analysis of electronic transactions is on file with CRL.

[38] Leslie Parrish and Peter Smith, *Billion Dollar Deal: Banks swipe fees as young adults swipe debit cards, colleges play along*, Center for Responsible Lending, at 1 (Sept. 24, 2007), *available at* http://www.responsiblelending.org/pdfs/billion-dollar-deal.pdf (last visited July 12, 2008).

[39] *Shredded Security*, *supra* note 5, at 7-8.

The average debit card overdraft is under $17,[40] yet it triggers an average fee of $34. Account holders, then, are paying nearly $2 in fees for every dollar of credit extended through debit card overdrafts.[41] The Agencies have clearly noted the lack of benefit gained from being charged an overdraft fee for an ATM or point-of-sale transaction.[42] While industry defends overdraft coverage of paper checks as a guard against merchant fees triggered by bounced checks, there is no analogous penalty with debit card and ATM transactions: they could easily be denied on the spot with no consequence at all. As recently as 2004, 80 percent of banks denied these transactions when the customer lacked sufficient funds. It would be surprising—shocking, in fact—if banks couldn't accomplish now technologically what they could in 2004.[43]

SHCU denies all debit and ATM transactions it processes real-time if the account holder lacks sufficient funds and charges no fee even if the transaction is inadvertently paid. At the very least, institutions should be required to obtain customer consent at the terminal after providing warning of the overdraft and the amount of the fee. They should be required to disclose: "You are about to overdraft your account and incur a $__ fee. You must agree to this $__ fee to proceed with this transaction," or something equally straightforward. As it stands now, however, *there is no benefit gained from fee-based overdraft coverage of the most common trigger of overdrafts*.

Currently, charging NSF fees for denied debit or ATM transactions is not a common practice. Clearly, however, charging an NSF fee for these transactions—which the institutions can easily deny at the terminal, before the transaction is completed by the merchant or ATM—is an unfair practice. Applying much of the same analysis the Agencies apply in their UDAP analysis of fee-based overdraft programs, charging a fee for debit and ATM transactions clearly meets all three prongs of the FTC test for unfairness. NSF fees for the growing number of transactions made with debit cards would cause substantial injury. They could not be easily avoided since, as the Agencies acknowledge, account holders often lack sufficient information to know their balance

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[40] The average overdraft amount for debit card transactions is $16.46. *Debit Card Danger*, *supra* note 32, at 25.

[41] Account holders pay $1.94 in fees for every $1 of credit extended for debit card overdrafts. *Id.*

[42] 73 Fed Reg. 28929. The Agencies state: "The benefits to consumers and competition from not providing an opt-out do not appear to outweigh the injury. This is particularly the case for ATM withdrawals and POS debit card transactions where, but for the overdraft service, the transaction would typically be denied and the consumer would be given the opportunity to provide other forms of payment without incurring any fees." *Id.* They also note that "for many POS transactions, the amount of the fee may substantially exceed the amount of the overdraft loan" and that multiple fees may be charged in a single day due to multiple small-dollar overdrafts. *Id*.

[43] Mark Fusaro, *Are "Bounced Check Loans" Really Loans?*, note 4, at 6 (Feb. 2007), *available at* http://personal.ecu.edu/fusarom/fusarobpintentional.pdf (last visited July 1, 2008). *See also* Sujit Chakravorti and Timothy McHugh, *Why Do We Use So Many Checks?* Economic Perspectives, 3rd Quarter 2002, Federal Reserve Bank of Chicago, 44, 48 ("When using debit cards, consumers cannot overdraw their accounts unless previous credit lines have been established.")). Should the Agencies retain their opt-out proposal, they should make it an unfair practice to charge an overdraft fee for debit point-of-sale and ATM transactions without providing a warning and an opportunity to cancel.

with certainty.[44] And the injury is clearly not outweighed by countervailing benefits to consumers or competition (*see* Section B.3 below). Allowing NSF fees to be charged for these transactions would undercut the intent of the Proposed Rule. In the final rule, therefore, we urge the Agencies to explicitly prohibit charging an NSF fee for debit or ATM transactions as an unfair practice.

c. The majority of overdraft fees are paid by a small group of core account holders least able to recover from them.

Two CRL surveys, conducted in 2006 and 2008, found that 71 percent of overdraft fees were shouldered by only 16 percent of respondents who overdrafted, and those account holders were more likely to be lower income, non-white, single, and renters when compared to the general population.[45] Respondents reporting the most overdraft incidents were those earning below $50,000.[46]

Overdraft fees strip funds from Americans of all ages, but our research indicates they hit America's youngest and oldest checking account holders—often the least financially stable—especially hard. Older Americans aged 55 and over pay $4.5 billion of the $17.5 billion total overdraft fees paid annually,[47] an especially alarming figure given that one in four retirees has no savings of any kind.[48] Moreover, Americans on Social Security pay over one-third of the fees

[44] 73 Fed. Reg. 28929.

[45] CRL Research Brief, *supra* note 20. Other research is consistent with CRL's findings. One bank consultant has estimated that only four percent of consumers pay half of all overdraft fees. Alex Berenson, *Banks Encourage Overdrafts, Reaping Profit*, The New York Times, Jan. 22, 2003 (citing an article on bankstocks.com and the estimate by Ralph Haberfeld); in 2005, a banking analysis estimated that the poorest 20 percent of all accountholders pay 80 percent of all overdraft fees. Jean Ann Fox, Patrick Woodall, Consumer Federation of America, *Overdrawn: Consumers Face Hidden Overdraft Charges from Nation's Largest Banks*, at 19 (June 9, 2005), *available at* http://www.consumerfed.org/pdfs/CFAOverdraftStudyJune2005.pdf (last visited July 7, 2008) [hereinafter CFA Report] (citing Dean Foust, *Banks: "Protection" Racket?*, Business Week, May 2, 2005 (citing Howard K. Mason, banking analyst at Sanford C. Bernstein & Co.)).

[46] CRL Research Brief, *supra* note 20. In fact, our survey indicated an uninterrupted increase in repeat overdrafting with every decrease in income category. The percentage of respondents who overdrafted four or more times in the previous six months was 3 percent for those with income of $50,000 or greater; 5 percent for those with income between $35,000 and $49,999; 6 percent for those with income between $25,000 and $34,599; and 7 percent for those with income below $25,000. *Id.* at 2. An ABA survey is consistent with CRL's findings. It found that while 18 percent of customers earning $50,000 or more had paid an overdraft fee in the last year, 42 percent of customers earning less than $50,000 had paid a fee. It also found that only four percent of those earning $50,000 or more paid at least ten fees in the last year, while 15 percent of those earning under $50,000 paid at least ten fees. ABA Survey, *80 Percent of Consumers Have Not Paid Overdraft Fee in Past Year, Says ABA Survey*, Aug. 29, 2007, *available at* http://www.aba.com/Press+Room/083007ABASurvey.htm (last visited July 14, 2008) [hereinafter ABA Survey].

[47] *Shredded Security*, *supra* note 5.

[48] *Id.* at 4 (citing 2008 Retirement Confidence Survey, Employee Benefit Research Institute (April 2008) finding that 28 percent of retirees have no savings). *Shredded Security* also notes that even those who do have savings are increasingly spending it on rising healthcare costs (citing Paul Fronstin, *Savings Needed to Fund Health Insurance and Health Care Expenses in Retirement*, Employee Benefit Research Institute (July 2006), projecting that retired couples will need between $300,000 and $550,000 to cover health expenses such as long-term care).

paid by older Americans.[49] Those heavily dependent on Social Security pay nearly $1 billion,[50] while those entirely dependent on Social Security pay over $500 million.[51] This is simply unjustifiable, especially when the Agencies explicitly acknowledge that account holders likely to overdraft often benefit more in the long run if they are not allowed to overdraft.[52] As soon as these account holders' Social Security payment is credited to an overdrawn account, the bank immediately takes a portion of the deposit to pay itself overdraft fees. So the federal protection Social Security benefits receive in almost all other debt contexts is absent in the overdraft context,[53] adding abuse at the hands of their bank to the list of worries already burdening these vulnerable Americans.[54]

At the other end of the age spectrum, young adults who earn relatively little as students or new members of the workforce pay nearly $1 billion per year in overdraft fees.[55] Because they are far more likely to use a debit card for small transactions than older adults,[56] they pay $3 in fees for every $1 borrowed for debit card overdrafts.[57] The situation is exacerbated by deals banks make with universities to provide school ID cards that double as debit cards. Banks pay the partner school for exclusive access to the student population and sometimes even split the fee revenue they collect on debit card transactions with the university.[58] In 2006, an estimated 100 to 125 of these bank/university partnerships already existed.[59]

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[49] Americans aged 55 and over pay $4.5 billion in overdraft fees. Social security recipients $1.5 billion, or 34 percent of the total. *Shredded Security, supra* note 5, at 6.

[50] *Id.* at 6, Table 1. "Heavily dependent" was defined as recipients who depended on Social Security for at least 50 percent of their total income.

[51] *Id.*

[52] The Agencies state: "Moreover, consumers relying on overdraft services may be more likely to overdraw their accounts, thereby increasing overdrafts in the long run." 73 Fed Reg. 28929.

[53] 42 USC 407(a): "The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law."

[54] *See, e.g. Shredded Security, supra* note 5, at 5 (quoting a consumer, Diane, in a letter to her Congresswoman: "In June of this year my mother discovered a bill from [major national bank] . . . Charges on the bill amounted to over $800.00 and was the result of over-draft protection charges and fees. My father is eighty-eight years old and has been diagnosed with dementia.").

[55] *See Billion Dollar Deal, supra* note 38.

[56] Seven out of ten young adults would use a debit card for purchases costing less than $2. *Id.* (citing Visa USA Generation P Survey, conducted July 24-27, 2006. Findings and discussion at http://corporate.visa.com/md/nr/press638.jsp (last visited July 9, 2008)).

[57] *Billion Dollar Deal, Id.*

[58] *Id.* at 7 (citing *U.S. Bank Pays Campus for Access to Students*, Milwaukee Journal Sentinel, June 18, 2007 (noting the agreement between US Bank and the University of Wisconsin at Oshkosh prohibits all financial institutions other than US Bank and the college's own credit union from locating ATMs on campus); Amy

Military families, whom Congress has taken recent action to protect from payday and other predatory lending practices,[60] remain vulnerable to abusive fee-based overdraft practices. An executive vice president of one turnkey overdraft system vendor has been quoted as saying, "Areas of high unemployment . . . you typically have more activity . . . . If you happen to be a bank that's on a military post, you're probably doing twice as much activity as any other bank."[61]

d. The potential for abuse is growing—and fast.

Account holders currently pay an average of $34 per overdraft,[62] but it hasn't always been this high. From 1997 to 2007, the average overdraft fee charged increased an overwhelming 76 percent.[63] The frequency with which institutions pay overdrafts instead of denying transactions is also increasing. In 2006, we estimated that overdraft fees accounted for 69 percent of all overdraft and NSF fees combined; just two years earlier, we estimated that 60 percent were overdraft fees,[64] so the trend is upward. Debit transactions have increased as a percentage of all overdraft triggers in part because banks routinely approve point-of-sale and ATM transactions,

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Milshtein, *In the Cards*, College Planning & Management (Dec. 2005) (noting the fee-sharing deal Higher One has with partner universities)).

[59] *Billion Dollar Deal*, *Id.*, at 7, n.9 (citing Nadia Oehlsen, *Banks Go Back to School with Campus Card Partners*, Cards & Payments, Oct. 1, 2006). In addition, CR80 News, which tracks university identification technology, estimates 115 partnerships between schools and banks. *See Banks Give College Try With Branded Cards*, ATM & Debit News (Aug. 31, 2006). *Id.*

[60] In 2006, Congress passed the Talent-Nelson Amendment to the Defense Authorization Bill for 2007, capping loans to military borrowers at 36 percent APR, among other protections. Pub. L. No. 109-364, 120 Stat. 2266-2269.

[61] Berenson, *Some Banks Encourage Overdrafts*, *supra* note 45 (quoting Dick Gowdy, executive vice-president, Strunk & Associates).

[62] The Agencies cite the recent Government Accountability Office report on bank fees, *Bank Fees: Federal Banking Regulators Could Better Insure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts*, GAO Report 08-291 (Jan. 2008) [hereinafter GAO Bank Fees Report], and Bankrate's findings that the average overdraft fee is $26 and $28, respectively. These figures reflect the average *charged* by institutions—i.e., they are computed by adding up the fees charged by each institution surveyed and dividing by the total number of institutions surveyed. Our research reflects the average *paid* by account holders. It is not surprising that it is larger since larger institutions with more customers generally charge higher fees. *Id*. at 16 (noting larger institutions' average NSF and overdraft fees were higher than smaller institutions').

[63] Statistics indicate that from 1997 to 2007, the average overdraft fee charged increased from $16.50 to $29. The Board's research indicates that the average was $16.50 in 1997 (*see* Federal Reserve Bulletin, *Retail Fees of Depository Institutions, 1997-2001*, 405, 409, *available at* http://www.federalreserve.gov/pubs/bulletin/2002/0902lead.pdf (last visited July 7, 2008) and $21.82 in 2002 (*see* Board of Governors of the Federal Reserve System, *Annual Report to the Congress on Retail Fees and Services of Depository Institutions* at 5 (June 2003), *available at* http://www.federalreserve.gov/boarddocs/rptcongress/2003fees.pdf (last visited July 17, 2008)). The latest Bankrate survey on overdrafts found that the average charged was $29 in 2007. Bankrate, *2007 Courtesy Overdraft Study*, *available at* http://www.bankrate.com/brm/news/chk/20071219_overdraft_survey_main_a1.asp (last visited July 7, 2008).

[64] *Out of Balance*, *supra* note 30, at 10.

when they previously denied them for no fee when sufficient funds were not available.[65] Banks are also more commonly charging additional daily fees for having a negative balance, also called sustained overdraft fees, in addition to the standard overdraft fee.[66]

Absent meaningful regulatory reform, generating overdraft fees will only get easier as debit card transactions continue to skyrocket.[67] Debit card transactions will not only continue to grow as a percentage of all bank transactions, but they will continue to provide banks more transactions *overall* as more account holders use them in place of cash for small transactions. Further, since account holders often make these small transactions several times per day, the opportunity for cascading fees—which, if limited at all, top out at about $245 per day[68]—is also on the rise.

In addition, institutions will be further motivated to increase overdraft revenue to compensate for the slowdown in the mortgage industry.[69] A recent *USA Today* article cited an internal memo at one major bank stating: "We are in an economy that is requiring us to tighten our belt and ensure that we are looking for every possible way to generate revenue."[70] The bank urged employees not to reverse too many overdraft fees because they "make up a big percentage of our revenue and is [sic] a HOT button among leadership."[71] Banks will look for more aggressive and creative ways to get higher performance out of their second-most profitable source: unsolicited, high-cost, abusive overdraft loans.

Given that the overall cost of fee-based coverage exceeds the benefit, both in the aggregate and for the majority of transactions; that the most common trigger of overdraft fees are debit card transactions, which generate large fees for small purchases and cost the account holder nothing when denied; that the majority of overdrafts are paid by a small group of core account holders least able to afford them; that fee-based overdraft leaves these account holders worse off than either a cheaper alternative or no coverage at all; and that the potential for abuse is growing quickly, there is no doubt that these programs harm account holders more than benefit them. (They also clearly meet the substantial injury prong of the FTC's test for an unfair practice—*see* complete UDAP analysis in Section B, below.)

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65 *See*, *supra*, note 43 and accompanying text.

66 CFA's 2005 survey found that 50 percent of the nation's largest banks charged a sustained overdraft fee then. Its 2008 survey found that 60 percent charge this fee now. CFA Press Release, *New Study: Most Big Banks Level High "Courtesy Overdraft" Loan Fees Without Consumers' Permission*, June 9, 2005, *available at* http://www.consumerfed.org/pdfs/overdraft_release_060905.pdf (last visited July 30, 2008); CFA's comments filed in this docket.

67 *See*, *supra*, note 34 and accompanying texts,.

68 *See*, *supra*, note 16.

69 Yuki Noguchi, *Rising Bank Fees Squeeze Consumers*, National Public Radio, June 26, 2008, *available at* http://www.npr.org/templates/story/story.php?storyId=91888705&ft=1&f=2.

70 Kathy Chu, *Banks Raise Penalty Fees for Customers' Overdrafts*, USA Today, June 18, 2008 (citing Wachovia internal correspondence).

71 *Id.*

3. Account holders overwhelmingly want a choice about overdraft, and they don't want transactions covered when they could easily be denied for no fee.

Approximately 90 percent of account holders want to choose whether or not they are enrolled in a fee-based overdraft program.[72] For account holders to have a meaningful choice, they should not be enrolled unless they affirmatively choose to be. As we discuss in our UDAP analysis in Section B below, relying on a disclosure to make account holders aware that they can opt out does not amount to a meaningful choice. The Agencies assert that the Proposed Rule "would allow each account holder to decide whether this benefit [of having overdraft transactions paid] sufficiently compensates for the cost of the overdraft fees."[73] The Agencies, however, offer no empirical evidence showing that account holders would in fact prefer to be automatically enrolled than to be given a meaningful choice. Despite this lack of evidence, they nonetheless deprive account holders of a critical choice—the choice to be enrolled in the first place.

Moreover, regarding the transactions that could easily be denied for no fee, such as point-of-sale debit transactions, an overwhelming majority of account holders have said they would prefer to have their transaction denied, whether their purchase is for $5 or $40.[74] Eighty percent would prefer the bank deny a $5 purchase; 79 percent a $20 purchase; and 77 percent a $40 purchase.[75] Again, we know of no empirical evidence suggesting account holders want these transactions covered, yet banks routinely approve debit card point-of-sale and ATM transactions, without warning, when an overdraft will result. The Agencies proposed rule flies in the face of account holders' stated preferences.[76] If, on the other hand, the Agencies set the default as no fee-based coverage, they would align the default with what the majority of account holders want.

This stated preference strongly refutes what industry would have us believe—that account holders want and appreciate fee-based overdraft coverage. The American Bankers Association (ABA) has claimed that its survey indicates that account holders are glad to have their overdrafts covered,[77] but its survey failed to notify account holders that any other less-costly options were

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[72] A January 2008 CRL survey found that of consumers with a preference, 88 percent of all consumers, and 91 percent of respondents enrolled in a fee-based program, want a choice about whether or not a loan program is included with their account. The preference was even stronger among those who had overdrawn their account in the last six months, 94 percent of whom would prefer a choice about enrollment in the program. CRL Research Brief, *supra* note 20.

[73] 73 Fed. Reg. 28929.

[74] CRL Research Brief, *supra* note 20.

[75] *Id*. Consistent with our findings, a 2004 poll of a representative sample of 1,000 adult Americans conducted for CFA by Opinion Research Corporation International found that 82 percent of consumers thought permitting overdrafts without any notice at the ATM was "unfair," with 63 percent saying it was "very unfair." Only 17 percent of people thought it was fair. http://www.consumerfed.org/pdfs/CFAOverdraftStudyJune2005.pdf

[76] Institutions routinely ignore not only consumer preferences, but the Agencies' guidance as well. *See*, *supra*, text accompanying note 4.

[77] *See*, *e.g.*, ABA Survey, *supra* note 46. Nessa Feddis of the American Bankers Association, Testimony before the House of Representatives Committee on Financial Services' Subcommittee on Financial Institutions and Consumer

available.[78] *Industry consistently ignores the reality that most account holders have dramatically cheaper alternatives to fee-based overdraft programs they just are not aware of,* like automatic links to savings accounts, overdraft lines of credit, or links to credit cards. *Industry also ignores the distinction between traditional check transactions and debit and ATM transactions that could easily be denied for no fee*, or at a minimum, could include a warning offering account holders the chance to cancel the transaction before triggering an overdraft.

The above discussion provides more than ample support for setting the default at no fee-based coverage, which doesn't cause account holders more harm than benefit and better reflects account holder preferences.

B. Charging Overdraft Fees Without the Account Holder's Affirmative Consent Is an Unfair and Deceptive Practice Under the FTC Act.

Under the FTC Act, to be considered unfair, (i) an act must cause or be likely to cause substantial injury to consumers; (ii) the injury must not be reasonably avoidable by consumers; and (iii) the injury must not be outweighed by countervailing benefits to consumers or to competition.[79] We agree with the Agencies' analysis finding that charging an overdraft fee without allowing a reasonable opportunity to opt out constitutes an unfair or deceptive practice. However, the Agencies must prescribe a different solution to the problem if they hope to cure it. They must require institutions to obtain opt-in up front. Providing an opportunity to opt out later does not make an unfair practice a fair one.[80]

1. Automatically enrolling account holders in the most expensive overdraft program available causes substantial injury to consumers.

We agree with the Agencies' analysis finding that fee-based overdraft programs can cause consumers substantial injury. We discussed the injury caused in Section A.2, above, demonstrating that it in fact far exceeds the benefits account holders derive from these programs. We also discussed, in Section A.1, that account holders are unlikely to opt out once they are automatically enrolled. It only follows that allowing institutions to automatically enroll customers in fee-based overdraft programs *unless* they opt out, as the Agencies propose, *causes greater injury* than providing them fee-based coverage *only if* they affirmatively opt in.

Credit (July 11, 2007), *available at* http://aba.com/NR/rdonlyres/222CE044-577A-11D5-AB84-00508B95258D/48244/OverdraftsNessaFeddisJuly112007.pdf (last visited July 9, 2008). Feddis states: "Consumers value banks' practice of paying overdrafts. Indeed, they expect it. They value the ability to avoid the embarrassment, hassle, costs and other adverse consequences of having a check bounce or transaction denied."

[78] ABA Survey, *Id.*

[79] 15 USC 45(n).

[80] Should the Agencies adopt a rule requiring opt-in, they should also encourage public education about the new rule, so that consumers who have overdrawn their accounts with checks and electronic transactions in the past will know not to expect overdraft coverage to continue unless they opt into it.

2. Providing customers with an opt-out disclosure does not constitute a reasonable opportunity to avoid injury.

We agree with the Agencies' analysis of why it is difficult for account holders to avoid overdraft fees when they are enrolled in fee-based overdraft—"consumers often lack information about key aspects of their account" and "cannot know with any degree of certainty when funds from a deposit or a credit from a returned purchase will be made available."[81] However, mere notice offering an opportunity to opt out of the system does not provide a reasonable opportunity to avoid the injury caused by unauthorized overdrafts.

For the opt-out notice to protect account holders, they would have to *receive, read, understand, and respond to a disclosure.* The likelihood of this occurring is far too low to constitute a reasonable opportunity to opt out, and it's even lower in light of institutions' financial incentives to keep account holders from opting out.

a. Limitations of disclosure prevent account holders from having a reasonable opportunity to avoid injury under an opt-out arrangement.

The Agencies cannot rely on disclosure to protect account holders. Yet their UDAP determination of what constitutes a reasonable opportunity to opt out relies on it entirely.

We applaud the Board for its work in designing an opt-out notice that is strong in many respects. We submitted recommendations on this notice, as well as our own sample opt-out form, in CRL's 2008 Comments on Regulation DD.[82] However, as the Board acknowledges, many account holders will not focus on this disclosure when they open their account.[83] It is also unlikely that they will do so later, even after being hit with a fee. Financial disclosures are notoriously voluminous, confusing, and, ultimately, ineffective. In the mortgage industry, disclosures have miserably failed to enable borrowers to choose the least expensive loan.[84] In the payday lending arena, disclosure of triple-digit APRs has done famously little to slow down the industry. There is little reason to believe that disclosure alone will significantly curb the abuse in the overdraft industry, either.[85]

[81] 73 Fed. Reg. 28929.

[82] *See* CRL's 2008 Comments on Regulation DD, *supra* note 8, Appendix B, and accompanying discussion at 13-21 of those comments.

[83] 73 Fed. Reg. 28743.

[84] *See*, *e.g.*, the Board's discussion of the limitations of disclosure in the mortgage industry in its Proposed Rules Regarding Unfair Practices Under the Home Ownership and Equity Protection Act, 73 Fed. Reg. 1675-76 (2008).

[85] The GAO Bank Fees Report found that many financial institutions do not comply with existing fee disclosure requirements. Institutions failed to provide a comprehensive list of fees 22 percent of the time and failed to disclose terms and conditions, including information on when deposited funds became available and how overdrafts were handled, 33 percent of the time. GAO Bank Fees Report, *supra* note 62, *Id.* 36-37.

b. Banks' financial incentives further prevent an opt-out arrangement from providing account holders a reasonable opportunity to avoid injury.

The $17.5 billion institutions earn each year in overdraft fees represents almost half of the $38.6 billion in total service charge revenue they earned in 2007.[86] In 2003, a majority of banks surveyed by the ABA named overdraft lending as their second most profitable service behind residential mortgages.[87] The increase in overdraft fees, a function of both an increase in the amount of the fee[88] and in the number of overdrafts paid,[89] is the result of a concerted effort on the part of many financial institutions to maximize overdraft revenue.

Overdrafts are such a major source of fee income for institutions that they pay consultants for specialized proprietary software and implementation strategies to generate more fees. The number of institutions using vendor-based automated overdraft loan programs has exploded in recent years.[90] The consulting firms publicly tout the dramatic increases in fee revenue their programs generate.[91] Some of the consultants even offer software implementation and employee training at "no risk," charging the client only a percentage of the increased fee revenue the software generates.[92] They can offer clients this no-risk arrangement with confidence because their turnkey systems accomplish what they promise. Client testimonials on the firms' websites back up the consultants' claims.[93]

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[86] Noguchi, *Rising Bank Fees Squeeze Consumers, supra* note 69.

[87] Laura K. Thompson, *Bank Overdraft Programs Rankle Consumer Groups*, American Banker, May 20, 2003 (reporting on findings from ABA Community Bank Competitive Survey Report released in Feb. 2003).

[88] *See*, *supra*, note 62 and accompanying text.

[89] *See*, *supra*, note 64 and accompanying text.

[90] *See* CFA Report, *supra* note 45, at 1.

[91] *See*, *e.g.*, Impact Financial Services' website: "Virtually all of our clients have increased the NSF fee income from 50-150% or more (with 100% or more being the norm) . . . ." https://impactfinancial.com/portal/AboutIFS/FromPresidentsDesk/tabid/66/Default.aspx (last visited July 7, 2008); Moebs $ervices, Inc.'s website: "Typical results after one year of using No-Bounce: overall fee income is increased by 200%." http://www.moebs.com/Default.aspx?tabid=102 (last visited July 9, 2008).

[92] *See*, *e.g.*, Impact Financial Services' website: "Since we don't charge up-front or implementation costs and our fee is a percentage of the increased NSF income you earn from the service, you have no financial risk! We become partners with a common goal—your success." https://impactfinancial.com/portal/WhatisIOP/HowTheProgramWorks/tabid/65/Default.aspx (last visited July 7, 2008).

[93] *See*, *e.g.*, the testimonials of Impact Financial Services' clients: "If I had two more products like the IMPACT Automated Overdraft Privilege, I could quit making loans altogether. The fee income increase has been great." https://impactfinancial.com/portal/Endorsements/ClientTestimonials/tabid/70/Default.aspx (last visited July 7, 2008); Strunk & Associates' clients: "Strunk forecasted that we would double our revenue and that is what we did." http://www.globenetix.com/custom.asp?id=128274&page=13 (last visited July 7, 2008).

The shift in institutions' attitudes toward overdraft—at large and small institutions alike—is revealed by the President and CEO of a $1.3-billion asset bank in California: "Years ago, if you overdrew your account, we couldn't wait to close your account and throw you out. Now we have to go find those people and bring them in, because they are really valuable folks to have."[94]

Given these incentives, financial institutions will have every reason to ensure that new account holders do not opt out of fee-based overdraft coverage. Employees will likely be encouraged to detract attention away from the opt-out form or to actively discourage customers from opting out. Once account holders are automatically enrolled, absent further action by the Agencies not included in this Proposed Rule, institutions will continue to maximize fees in at least three ways: (i) by routinely approving debit card point-of-sale and ATM transactions even when an overdraft will result;[95] (ii) by manipulating the order in which they clear transactions so that higher-dollar items are withdrawn first, maximizing the number overdrafts (see Part IV); and (iii) and by posting debits as quickly as possible, while delaying for as long as possible making deposits available for use (see Section III.B).

In an opt-out arrangement, account holders will lose, because their best hope of avoiding injury hangs on a disclosure – and, likely, an institution intent on keeping them from noticing it.

3. <u>The injury caused is clearly not outweighed by countervailing benefits to consumers or competition.</u>

With respect to consumer benefit, we explain in Section A above why the potential benefits of fee-based overdraft coverage are far outweighed by the injury caused. Coverage of debit transactions offers no benefit to account holders—what could the possible benefit be from a $34 loan fee to buy a $3 coffee? Coverage of checks and electronic transactions drives account holders further into debt and prevents them from meeting obligations they otherwise would have been able to meet.

With respect to competition, institutions don't currently compete based on price of overdraft coverage or overdraft practices. Industry attrition rates show that, in reality, account holders generally don't seek out other institutions. Research suggests that this lack of shopping around isn't due to loyalty or high customer satisfaction—in fact, customers are 23 percent more satisfied at institutions that don't charge fees—but because of the time and cost involved in changing financial institutions.[96] The time and cost to find an institution without an abusive overdraft system is only increasing as institutions, large and small, are finding ways to raise

[94] Anthony Malakian, *Overdraft and ATM Fees Rise, As Economy Slumps; Upping overdraft and ATM fees has become the new strategy for many banks caught in the downward economy. Is it worth the bad taste it leaves in consumers' mouths?*, US Banker, June 1, 2008 (quoting James Holly, President and CEO of Bank of the Sierra in Porterville, CA). *See also* recent Wachovia internal memo at text accompanying note 71.

[95] *See*, *supra*, note 43 and accompanying text.

[96] Malakian, *supra* note 94, quoting Greg Lowell, senior manager in the financial services strategy group for research company Accenture).

overdraft revenue with unfair practices.[97] In addition, research has consistently shown that consumers are often unable to obtain information about fees, even upon request, prior to opening a checking account.[98] Consumers cannot shop based on information institutions won't let them have.

For the reasons noted in Section A.1, we don't expect institutions to receive a significant number of opt-out requests from account holders, so we don't expect the Agencies' opt-out proposal to promote greater competition. Opt-in, on the other hand, may encourage account holders to explore their options by shopping around.

C. Industry Offers No Compelling Reasons to Require Anything Less Than Account Holders' Affirmative Opt-In.

Based on our discussion in Section A.2 above, there is no question that the increase in overdraft fees is the result of systematic efforts by institutions to increase fee revenue. Industry's attempts to justify these fees on their own merits often appear disingenuous and contradictory. As we discuss in the following paragraphs, the glaring contradiction lies in two of industry's most common defenses of overdraft. On one hand, it claims that overdraft fees are meant to deter account holders from spending more than they have in their account; on the other hand, it claims that overdraft is a convenient source of emergency cash. Finally, industry also claims that regulation of overdraft fees isn't necessary because account holders should know their own balance, but the Agencies themselves acknowledge that this is an unfair expectation.

In a recent response to a *USA Today* editorial that criticized industry overdraft practices,[99] the ABA began by stating that overdraft fees are meant to be deterrent. Presumably, the ABA means that charging a customer a fee for one overdraft is intended to make it less likely that the customer will overdraw his or her account again because overdrafts are undesirable. The ABA claims that overdrafts are undesirable, stating that "[o]verdrafts slow down our nation's efficient payment system and increase costs for everyone." Industry's argument appears disingenuous, however, because if institutions really wanted to deter overdrafting, they would simply deny customers' debit and ATM transactions at the terminal, instead of allowing them to overdraft over and over again.

The ABA's argument also appears contradictory because, in the same brief article, it continues by offering the following justification for allowing overdrafts: "Can you imagine a midnight run

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[97] *See* Section A.2.d, *supra*, discussing the continuing growth in abusive practices.

[98] *See, e.g.*, GAO Bank Fees Report, *supra* note 62, at 6 (finding that financial institutions, even upon request, failed to provide a comprehensive list of fees 20 percent of the time and failed to disclose terms and conditions, including information on when deposited funds became available and how overdrafts were handled, 33 percent of the time, and that of those branches that did not provide a comprehensive list of fees upon request, representatives at 35 percent of them nonetheless assured consumers that they had all the fee information they needed to comparison shop); U.S. PIRG, *Big Banks, Bigger Fees 2001, PIRG National Bank Fee Survey* (Washington, D.C. November 2001), summary *available at* http://static.uspirg.org/usp.asp?id2=5033&id3=USPIRG& (last visited July 8, 2008).

[99] Edward Yingling, President and CEO, ABA, *Opposing View: Fees are a deterrent – Banks offer several ways to keep customers from overdrawing*, USA Today, June 23, 2008 [hereinafter ABA Op-Ed].

to the grocery store for baby formula, then finding your purchase is declined because your account was overdrawn?" Presumably, then, in this special case, it is in fact desirable to charge a struggling mother $10 *plus* a $34 fee for her baby formula—$44 total—rather than the $10 the formula actually costs. A low-cost overdraft program, a $10 bill, or even a charge to a credit card would have been far better options for this mother than incurring $34 in debt.[100]

Industry's justification of fee-based overdrafts as a needed source of emergency funds poses at least three problems. First, it is inconsistent with the ABA's other position, that overdraft fees should deter people from spending funds they don't have. Second, it ignores the reality that most account holders have dramatically cheaper alternatives to fee-based overdraft programs they just are not aware of, like overdraft lines of credit and automatic links to savings accounts or credit cards. Instead, the ABA presents the account holder's dilemma as a two-dimensional, either/or scenario—to have the transaction covered for an expensive fee or to have the transaction is denied. This limited choice is not warranted given the overwhelming percentage of institutions that offer cheaper alternatives.[101] Lastly, the ABA's example perpetuates the misconception that struggling Americans are better off with fee-based overdraft than they are with no coverage at all—when our case study (*see* Section A.2 above) clearly illustrates that the exact opposite can be true. Certainly, there is a wide range of policy solutions that must be explored to address why some individuals so often have insufficient funds in their checking accounts—including education, employment, healthcare, and public assistance. But the just solution cannot be to allow institutions to effectively slap a $34 surcharge on many of these account holders' everyday purchases.

Finally, in a subtle attempt to discourage regulation—by placing responsibility for institutional abuse at the feet of the account holder—the ABA has further claimed that keeping track of one's bank account is easier than ever before because of the ability to check one's balance electronically.[102] The Agencies, however, acknowledge the difficulty of knowing one's own balance in the Proposed Rule, noting that "consumers often lack information about key aspects of their account" and "cannot know with any degree of certainty when funds from a deposit or a

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[100] Industry has claimed that fee-based overdraft coverage may be better for consumers than adding a purchase to an outstanding credit card balance. We know of no credit card on the market, however, more expensive than fee-based overdraft loans, for which the average loan amount, repaid only five days later, is less than the $34 cost of credit. *See, e.g.*, Strunk & Associates, L.P.'s comments on this Proposed Rule, Re: Proposed Amendments to Regulation AA, Docket No. R-1314 (June 18, 2008) at 3: "Consider a working mother who, along with her children, after spending to hours shopping for groceries, swipes her debit card . . . only to have her payment authorization denied due to insufficient funds . . . . If her choice is between incurring an overdraft service charge or adding to an outstanding credit card balance, it may be much cheaper in the long-run for her to incur the overdraft service fee."

[101] Nearly 85 percent of 33 of the nation's largest depository institutions surveyed in 2005 offered automatic links to savings accounts; nearly 82 percent offered overdraft lines of credit; and over 42 percent offered automatic links to a credit card. These alternatives were consistently significantly cheaper than the institutions' fee-based "courtesy" programs.

[102] ABA Op-Ed, *supra* note 99; *see also* Victoria McCrane, Consumers Fight for Choice in Overdraft Protection, *Politico*, June 25, 2008 (quoting Nessa Feddis, senior federal counsel for the ABA: "Ultimately, only the customer knows what checks they have written, what payments have been authorized and what debit cards have been approved.").

credit from a returned purchase will be made available."[103] Debit and deposit holds (*see* Part III) and the lack of transparency about the order in which transactions are cleared (*see* Part IV) contribute to account holders' confusion about their balances. Making matters worse, account balance disclosures often include funds available for overdraft, tricking customers into spending more money than they have.[104]

D. <u>If the Agencies Do not Require Opt-In for All Transactions, They Should Consider Other Alternatives That Provide Account Holders Greater Protection Than Opt-Out.</u>

Absent a decision to require opt-in, the Agencies should consider other alternatives that offer account holders more protection than their opt-out proposal. The alternative the Agencies should first consider, if they don't require opt-in for all transactions, is to at least require opt-in for debit and ATM transactions. Should the Agencies decide against requiring opt-in for any transactions, we offer several other suggestions below that would still mark an improvement over the opt-out proposal.

1. <u>Opt-in for debit cards and ATMs only.</u>

As noted in Section A.2.b above, the Agencies have acknowledged that there is no downside to having a debit card or ATM transaction denied, meaning the benefit provided by fee-based overdraft is none. At the same time, the cost is tremendous: debit card transactions that trigger overdrafts average less than half the amount of the overdraft fee.[105] Consequently, the cost/benefit analysis of fee-based overdrafts for these transactions *is not a close call*. At the very least, the Agencies should require institutions to obtain account holders' affirmative opt-in before subjecting them to the risk of unexpected overdraft fees for transactions that could be easily denied at no cost.

Some in industry have claimed that implementing fee-based coverage for some types of transactions and not for others is not technologically feasible. In the vast majority of circumstances, this argument is simply not credible. SHCU denies all ATM and debit card transactions when the account holder lacks sufficient funds, but it will approve checks and ACH transactions if customers have set up a low-cost overdraft option. It is feasible, then, for institutions to treat different transactions differently.[106]

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[103] 73 Fed. Reg. 28929.

[104] *See* 2008 Proposed Rule to amend Regulation DD, 73 Fed. Reg. 28743-44.

[105] *See* Section A.2.b, *supra*.

[106] The Agencies themselves acknowledged that while institutions may incur some programming costs to do so, "the benefits of providing consumers a choice" outweighs the costs to institutions. 73 Fed. Reg. 28930.

Some in industry have also claimed that their systems cannot distinguish between point-of-sale debit transactions and non-point-of-sale debit transactions, so they cannot allow consumers to choose that these transactions to be treated differently. At SHCU, non-point-of-sale debit transactions are converted into ACH-debits before SHCU receives them. As a result, SHCU knows that they are distinct from point-of-sale transactions, and they are processed like ACH transactions, not like point-of-sale transactions (see Part IV for discussion of how SHCU's

2. Opt-out for the first six overdraft incidents in the life of the account. Opt-in afterwards.

As we discussed in Section C above, industry justifies overdraft fees by claiming that covering overdrafts is a courtesy to help customers through short-term cash shortfalls. But as we discussed in Section A, our research suggests that overdraft fees for short-term loans are too often converted into a long-term, high-cost debt trap for those least likely to be able to dig their way out. Thirty-one percent of overdraft fees are paid by people who incur eight or more overdraft incidents per year; 53 percent are paid by those who incur six or more incidents per year.[107] The Agencies themselves warn that this sort of excessive overdrafting can harm account holders in the long run.[108]

To make it more likely that overdraft coverage provides account holders an occasional courtesy as industry claims, one option is to allow institutions to charge an account holder six overdraft fees during the life of the checking account before requiring them to obtain affirmative opt-in consent from the account holder.[109]

We choose six because, giving institutions the benefit of the doubt, it is reasonable to assume that account holders may occasionally inadvertently overdraw their account, or face a short cash shortfall, without being trapped in a debt cycle. But once account holders have overdrawn their account on more than six occasions, it is more than appropriate to require institutions to obtain their affirmative consent to be able to keep them enrolled in a system that is likely driving them into a debt trap.

This proposal would work as follows: Any time an account holder incurs an overdraft fee, the institution sends an opt-out notice, just as we suggest should occur if the current opt-out proposal is finalized.[110] However, the notice would also include the following statement:

> "You have been charged an overdraft fee _ times since you opened your account. We can only cover your overdrafts for a fee _ more times unless you contact us and give us your consent to charge you additional overdraft fees. If you do not contact us, and you try to spend funds you do not have in your account, your transaction may be denied and you may be charged a non-sufficient funds fee.

ACH transactions are processed). However, if institutions would prefer to treat all debit transactions like point-of-sale debit transactions, we don't object.

[107] CRL Research Brief, *supra* note 20.

[108] *See*, *supra*, note 52.

[109] In Section I.B, we urge the Agencies to establish a substantive cap on fees by finding it an unfair practice to charge more than four overdraft fees *per year* or, alternatively, more than one overdraft fee within a 60-day period. In this section, offering a less desirable measure than a substantive cap, but still more protective than the proposed opt-out arrangement, we recommend that only six fees be allowed *during the life of the account* before requiring institutions to obtain consumers' affirmative consent to additional overdraft loans.

[110] CRL's 2008 Comments on Regulation DD, *supra* note 8, at 23-25.

> You may also opt out of this fee-based overdraft coverage at any time by returning this form."

If an account holder does not opt in following the sixth fee, the institution may no longer cover the account holder's overdrafts for a fee unless the account holder later opts in.

3. Opt-in for new accounts; opt-out existing accounts.

If the Agencies are unwilling to require opt-in for all accounts, we encourage them to consider opt-in for new accounts and opt-out for existing accounts. While this would leave existing account holders in an unfortunately vulnerable position, at the very least, new account holders, including those new to the banking system, would not be automatically enrolled in an abusive program. In addition, this arrangement would allow institutions to phase in the opt-in program.

4. An overdraft fee for an overdraft of $20 or less is an unfair or deceptive practice. Or, an overdraft fee for an overdraft that is less than the amount of the fee charged is an unfair or deceptive practice.

An overdraft fee of $34 for an overdraft amount of $20 paid back five days later translates to an APR exceeding 19,600 percent. Surely this is a more than reasonable *de minimus* overdraft amount, below which charging an overdraft fee should constitute an unfair or deceptive practice. Another option is to prohibit overdraft fees charged for overdrafts smaller than the amount of the overdraft fee.

All of the above alternatives would provide account holders far greater protection than the Agencies' proposed opt-out arrangement.

E. A Partial Opt-Out Arrangement Would Severely Weaken an Already Weak Opt-Out Proposal.[111]

We commend the Agencies' effort to allow account holders to choose fee-based overdraft coverage for some transactions but not others. Reflecting the potential benefits of this arrangement, CRL's Opt-In Notice would allow account holders to choose to have checks and ACH transactions covered one way and debit and ATM transactions covered another.

The Agencies request comment, however, on whether requiring an opportunity to opt out should be limited to debit card point-of-sale and ATM transactions. We emphatically urge the Agencies not to weaken their current proposal by giving account holders no right to opt out of overdraft coverage for checks and ACH transactions. As noted earlier, nearly 90 percent of account holders want a choice about whether they have fee-based overdraft coverage.[112] To deny them any choice about whether or not certain transactions are covered would be outrageous.

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[111] 73 Fed. Reg. 28930, __.32(a)(2).

[112] *See*, *supra*, note 72.

Moreover, the harm caused by having checks and ACH transactions covered certainly justify, at a minimum, allowing account holders to opt out.

Twenty-eight percent of overdrafts are triggered by electronic transactions, comprised largely of ACH transactions, electronic bill pay, and debit transactions that are not point-of-sale.[113] Another 27 percent of overdrafts are triggered by checks. While checks will comprise a shrinking percentage of overdrafts going forward (*see* section A.1.a, above), electronic transactions will increase as more people do their banking on-line.

As we discussed in Section A, even if coverage of a check or electronic transaction may benefit some account holders in the context of a single covered transaction, fee-based overdraft for checks and electronic transactions ultimately harms account holders more than benefits them. For account holders who pay the majority of overdrafts, coverage causes repeat overdrafts that drive account holders deeper into debt and prevent them from meeting obligations they otherwise would have been able to pay. Public policy clearly supports giving account holders the option to select a cheaper alternative, like a line of credit, or no coverage at all, *for all types of transactions.*

F. Recommendations on the Opt-Out Proposal, if Adopted

1. An Opt-Out Rule, if Adopted, Must Apply to Existing Account Holders.

The Proposed UDAP Rule unequivocally states that a financial institution may not charge an overdraft fee without providing the opportunity to opt out.[114] The Proposed Rule on Regulation DD likewise states: "As applicable, the notice . . . must be provided: (1) Prior to the institution's imposition of a fee for paying a check or any other item when there are insufficient or unavailable funds in the consumer's account . . . ."[115]

The only statement indicating that the proposals are not intended to apply to existing account holders is in the discussion of the Proposed Rule to amend Regulation DD.[116] Nothing in this Proposed Rule indicates the same. The two proposals and the commentary supporting them may not be finalized as proposed without being irreconcilably contradictory.

Institutions would incur some cost to notify existing customers of their opportunity to opt out. But the cost, whatever it may be, is not unreasonable given the $17.5 billion account holders pay in overdraft fees each year. By not applying to existing account holders, the Proposed Rules leaves the *vast majority* of account holders outside of their protection. While some banks may

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[113] *Debit Card Danger*, *supra* note 32, at 24.

[114] "A bank must not assess a fee or charge on a consumer's account in connection with an overdraft service, unless the bank provides the consumer with the right to opt out of the bank's payments of overdrafts and a reasonable opportunity to exercise that opt-out and the consumer has not opted out." 73 Fed. Reg. 28943, §227.32.

[115] 73 Fed. Reg. 28748, §230.10(c)(1).

[116] 73 Fed. Reg. 28743.

claim that their customers can already opt out whenever they want, most account holders don't know this, and even those who explicitly ask to be unenrolled from fee-based overdraft programs have been charged overdraft fees nonetheless.[117]

Notification of existing customers is especially important in light of the relatively small number of existing customers who will open new accounts anytime soon. A 2003 estimate from a financial institutions consulting firm found that only 14 percent of banks' customers leave their bank each year.[118] Some existing customers are likely to be charged a series of cascading overdraft fees, amounting to hundreds of dollars, without first having the opportunity to opt out that the Proposed Rule purportedly requires.

If the Board is not going to alter its Proposed Rule on Regulation DD to require notice to existing account holders, the Agencies should require that the first overdraft incident covered for an existing customer be covered for no fee, and that the customer then receive notice and a reasonable opportunity to opt out before any overdraft fees are charged. This will preserve the intent of the regulation. Any less protective arrangement flies in the face of the Proposed Rule. If instead the Agencies determine that the Proposed Rules do not apply to existing account holders, they should write this major exception into the rules themselves so that the rules more honestly reflect the very limited nature of the protection they are offering existing account holders.

2. <u>The Proposed Rule Should Not Allow for Any Exceptions.</u>[119]

The Agencies have proposed allowing overdraft fees to be charged in two circumstances even after account holders have opted out. The first is when the debit purchase amount presented at settlement by a merchant exceeds the amount originally requested for pre-authorization, such as gas purchases authorized at $1 or restaurant transactions first processed without the tip.[120] The second is paper-based debit card transactions, where the merchant did not seek authorization at the time of the transaction.[121]

[117] *See, e.g.*, *Out of Balance, supra* note 30, at 5 n.6 (citing Paul Mulshine, *'Courteous' bankers in for a rude awakening*, The Newark Star-Ledger, June 7, 2007, at 15): A columnist for a New Jersey newspaper tested the banking industry's claim that these systems are voluntary by accompanying his daughter when she opened an account at Wachovia. The columnist told the account manager that they wanted any transaction to be declined if his daughter did not have the funds to cover it. But months later, when she did not realize her account was empty and made a debit card purchase of less than $2, the transaction was approved and she was charged a $35 overdraft loan fee.

[118] Michelle Higgins, *Direct Deposit, Online Billing Make Switching Banks Harder*, Wall Street Journal, Aug. 14, 2003 (citing estimates from Celent Communications); *see also* Bill Stoneman, *After Free . . . What Is There To Offer?*, Banking Strategies (May/June 2006) (citing Betty Cowell, Wachovia executive vice president and director of retail banking, noting that Wachovia enjoyed 11 percent household attrition versus an industry average of 14 percent); *see also* Laura Fuller, *A Simple Customer-Retention Strategy: Securing Direct Deposits*, ABA Bank Marketing, May 1, 2005 (noting that attrition rates range from 12 to 18 percent).

[119] 73 Fed. Reg. 28930, __.32(a)(3).

[120] 73 Fed. Reg. 28930, __.32(a)(3)(i).

[121] 73 Fed. Reg. 28930, __.32(a)(3)(ii).

These exceptions are not necessary and undermine the intent of the Proposed Rule. For account holders who have opted out, institutions should cover the transaction and charge no overdraft fee. They would still recover the amount of the overdraft, an average of five days later, when the account holder makes the next deposit. This is SHCU's policy. If a customer overdrafts too frequently, an institution always has the option to close the customer's account.

The Agencies request comment on a broad exception they considered but did not propose – to allow institutions to charge overdraft fees so long as they did not knowingly authorize a transaction for which there were insufficient funds.[122] The Agencies explain that they did not allow this exception out of concern that it would undermine the protections of the Proposed Rule. We agree with the Agencies' conclusion. The Agencies express concern, however, that the Proposed Rule without this exception could hurt small institutions that use daily batch processing or institutions using a stand-in processor because an ATM network is temporarily off-line.

SHCU is a relatively small institution that expects to continue using batch processing to some degree until mid-2009. With batch processing, customers' balances are updated only twice daily, allowing for the possibility that SHCU approves a transaction when the balance suggests the account holder had sufficient funds, but in reality, once all transactions in a batch are posted, the account holder didn't. When SHCU inadvertently pays an overdraft in this situation, it does not charge an overdraft fee. It is still repaid the amount of the overdraft loan the next time the customer makes a deposit. This occurrence happens infrequently and does not have a significant negative impact on SHCU. While smaller institutions may be at a disadvantage when their systems do not have the capacity of larger institutions' systems, those smaller institutions' customers should not be any more vulnerable to unfair practices than customers of larger institutions.[123]

3. <u>The Agencies Should Provide a Maximum Number of Days Institutions Have to Comply with Account Holder's Opt-Out Requests.</u>[124]

The Agencies propose that an institution must comply with a customer's request to opt out "as soon as reasonably practicable."[125] We agree with the Agencies' intent, but they should provide a maximum number of days institutions have to comply to help ensure they don't unnecessarily delay. SHCU is confident that three business days from the time the institution receives the customer's request is sufficient. The proposed regulations should be revised to read as follows:

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[122] 73 Fed. Reg. 28930-31.

[123] The Agencies also request comment on whether any additional exceptions should be considered, allowing institutions to charge consumers overdraft fees notwithstanding their having opted out. Any transactions so out of the ordinary that the Agencies have not yet contemplated them should not provide grounds for exception from the UDAP Rule. If an institution is unable to avoid the overdraft, it should cover the transaction without charging a fee.

[124] 73 Fed. Reg. 28931, __.32(a)(4).

[125] 73 Fed. Reg. 28931, __.32(a)(4).

> *A [bank/savings association /federal credit union, as applicable] must comply with a customer's opt-out request as soon as practicable, but no more than three business days after the institution receives it. When the customer sends the opt-out request via mail, it is considered to be received by the institution the earlier of (i) actual receipt or (ii) three days after the customer mails it.*[126]

III. DEBIT AND DEPOSIT HOLDS[127]

A. Charging Overdraft Fees For Overdrafts Caused Solely by Debit Holds Is an Unfair Practice.

We applaud the Agencies' finding that charging overdraft fees caused solely by debit card authorizations appears to be an unfair practice under the FTC standards. We also commend their clear illustration of their proposed rule, applying it to four different scenarios.

As the Agencies acknowledge, account holders are generally unaware of the practice of debit card holds,[128] and as a result, overdraft fees caused by them catch account holders especially off-guard. Industry itself has recognized that debit holds are not the ideal way to arrange for the transfer of funds. The ABA has announced that the banking industry is working to eliminate all debit holds,[129] and Visa is implementing real-time transaction clearing this fall, allowing transactions to be cleared immediately instead at the end of the day.[130]

We agree with the Agencies that charging fees in this instance causes substantial consumer injury and, as the Agencies point out, the injury can be compounded when account holders are charged cascading fees for multiple transactions.[131] In addition to the injury the Agencies discuss, institutions are causing further injury by their treatment of pending electronic transactions. Even if an account holder makes a deposit before the pending transaction becomes final, and therefore the account is never truly overdrawn, institutions will charge overdraft fees

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126 The Mortgage Disclosure Improvement Act (part of H.R. 3221, Housing and Economic Recovery Act of 2008, 110th Congress, 2nd session) provides that early TILA disclosures mailed by institutions be considered received by the consumer three days after mailing. Title V, § 2502(E). Consumers should be afforded a comparable benefit of the doubt when correspondence flows in the opposite direction, from consumers to institutions.

127 73 Fed. Reg. 28931, __.32(b).

128 *Id.*

129 Pumping with debit, Liz Crenshaw, NBC Channel 4 11:00 news (June 24, 2008), *available at* http://www.nbc4.com/consumer/16698978/detail.html (last visited July 30, 2008).

130 Press Release, Visa, *Visa to Help Ease Pain at the Pump: Lower Interchange Rates and Processing Changes Can Make Buying Gas Easier for Consumers and Benefit Gas Stations*, June 26, 2008, *available at* http://www.corporate.visa.com/md/nr/press789.jsp (last visited July 20, 2008).

131 73 Fed. Reg. 28931.

for any transactions that would have overdrawn the account if the pending transaction had been final.[132]

The Agencies solicit comment on the operational issue and costs involved in prohibiting fees caused solely by debit holds. SHCU deals with debit holds every day and does not charge overdraft fees. Since it doesn't typically know the amount of the final transaction at the time of the hold, it inadvertently covers some transactions for account holders when they don't have sufficient funds. It simply does not charge an overdraft fee in these instances, but it is repaid the amount of the overdraft itself the next time the customer makes a deposit.

Industry has expressed concern that the Agencies' debit hold proposal is not operationally feasible, but it has not offered a compelling reason for the Agencies to continue to allow this unfair practice. For example, industry has expressed concern about the difficulty involved in retroactively determining whether or not transactions would have caused an overdraft but for the authorization hold.[133] SHCU believes institutions would be able to program their systems to do so because they would have all the necessary data points: the date and the amount of all authorizations and the amount of all settled purchases. Ultimately, industry's concerns must be considered while at the same time recognizing that debit card holds are arrangements among merchants, card processors, and institutions designed to facilitate the transfer of funds from the institution to the merchant. How these three parties arrange for this to occur should not have an unfair impact on account holders.

B. Charging Overdraft Fees For Overdrafts Caused Solely by Held Deposits Is, Likewise, an Unfair Practice.

The Agencies should also prohibit overdraft fees caused solely because a customer accessed funds already deposited and received by the institution but not yet made available for use. When an institution has already received the funds from a deposit, customers should not be penalized because of a hold the institution voluntarily places on the funds that extends beyond when they have received them. (We do not, however, advocate a blanket prohibition on charging overdraft fees when the institution actually has not yet received the deposit.)

Deposit holds after funds have been received are especially unfair given the rapid increase in recent years in how quickly debits are posted due to Check 21, with no corresponding increase in the speed at which deposits are made available for use.[134] As a result, banks are able to receive a

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[132] *See* Kathy Chu, *Purchases Trigger Overdraft Fees Before They Clear*, USA Today, Aug. 4, 2008 (last visited Aug. 4, 2008) (noting that Bank of America and TD Banknorth began this practice this year, while SunTrust began a few years ago); Houston KPRC Channel 2, *Local 2 Investigates Bank Fees*, July 28, 2008, *available at* http://www.click2houston.com/news/17028831/detail.html (last visited Aug. 4, 2008).

[133] Strunk & Associates' Comments, *supra* note 100, at 5.

[134] The rules for how long institutions can hold deposits before crediting accounts have not been updated in 20 years, allowing institutions to hold certain nonlocal checks for up to 11 days. GAO Bank Fees Report, *supra* note 62, at 21. The limits set by regulators are no longer reflective of how quickly funds are transferred today. A spokesperson for a large national bank recently commented that the bank holds some deposits for as long as the law allows, unless the account holder calls and asks for a quicker credit. Peralte C. Paul, *Whose Money Is It? Checks*

deposit after, for example, one day, but not make it available to the customer for three days, enjoying two days' float on the customer's deposit *and* charging the customer overdraft fees for inadvertently spending the funds because they were included in their account balance on-line or at the ATM. Ultimately, and in the interest of parity in this environment of immediate debits, account holders should have access to their funds as soon as the bank does. But at the very least, institutions should not be able to charge customers for inadvertently accessing these funds.

IV. TRANSACTION CLEARING PRACTICES

We commend the Agencies for raising unfair transaction clearing practices in the Proposed Rule. However, we urge them to take immediate steps to curb the practice. This abusive practice is not a new problem. In fact, the Agencies have long expressed concern about it, encouraging institutions in their 2005 guidance to disclose to account holders how transactions are processed and that the order can impact the amount of fees charged.[135] The OTS explicitly said that, as a best practice, transaction-clearing processes should not be manipulated to inflate fees.[136] The Agencies should act now to prohibit manipulative clearing practices by finding that clearing transactions from high to low or clearing all debits before all credits, regardless of when they are received by the institution, is an unfair practice.

Institutions usually clear higher debits before lower ones so that the account is depleted sooner and more items cause overdrafts. They also offer well-buried disclosures that provide themselves the widest possible latitude to engage in this behavior.[137] They claim they do customers a favor by paying the largest, and presumably most important, items first to ensure those items get paid. But this argument is disingenuous in an age of fee-based overdrafts

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clear faster than ever, but deposits tend to creep into accounts slowly. Watchdogs want banks to change, Atlanta Journal Constitution, May 10, 2007. Most banks, in the interest of maximizing overdraft fees, likely do the same.

[135] Joint Guidance, 70 Fed. Reg. 9132; OTS Guidance, 70 Fed. Reg. 8341.

[136] OTS Guidance, 70 Fed. Reg. 8341.

[137] *See, e.g.*, US Bank's 26-page document, *Terms and Conditions for Deposit Accounts*, effective Feb. 1, 2005, *available at* https://fastapp.usbank.com/fastapp/en_us/termsAndConditions/TandC/LinkDepositAgreementCurrent.jsp (last visited June 29, 2008): "If we get a batch of such items in a day (checks typically come in batches), and if one, some or all of them would overdraw the account if paid, we can pay or refuse to pay them, in any order, or no order . . . . We have all these options each time you might overdraw an account. What we do one time does not make that a rule you can rely on for the future"; Bank of America's 36-page document, *Deposit Agreement and Disclosures*, *available at* https://www1.bankofamerica.com/efulfillment/documents/91-11-2000ED.20060701.pdf (last visited July 7, 2008): "We may . . . pay . . . items in any order we choose . . . . We may in our sole discretion change our . . . orders at any time without notice to you. Even if we provisionally post checks or other items to your account during the day, we may treat them as if we received all of them at the end of the day and process them in any order we choose. We do not process transactions in the order in which they occurred"; Wachovia, *Deposit Agreement and Disclosures for Personal Accounts*, effective Feb. 8, 2008, *available at* http://www.wachovia.com/personal/online_services/disclosure/view/0,,7,00.html (last visited July 7, 2008): "Although we generally pay larger items first, we are not obligated to do so and, without prior notice to you, we may change the order in which we generally pay items."

because banks have moved away from ad-hoc payment of overdrafts and now typically cover all of them, regardless of the order in which they are posted. So no matter what order the transactions are cleared in, all items get paid, and the only difference is how much the customer pays in overdraft fees. There is no benefit to the account holder, then, for institutions to both post transactions high-to-low *and* use fee-based overdraft programs.

In addition to clearing debits high-to-low, some institutions also routinely clear debits before credits to maximize fees. Further, as noted in our discussion of debit card holds, institutions are increasingly treating pending transactions as though they have posted, even if a deposit before the pending transaction becomes final, and the account never actually drops below zero.[138]

Manipulating the order in which transactions are cleared to maximize fees meets the three-pronged test as an unfair practice. First, it causes substantial consumer injury. In our report, *Out of Balance*, we provided a hypothetical example demonstrating the dramatic difference in overdraft fees that can result when an account holder's transactions are cleared high-to-low versus in the order in which they were presented to the institution by the processor.[139] In our example, an account holder had $750 in her checking account. Before she realized she did not have sufficient funds, she paid some bills and made several small dollar purchases, leaving her $143 in the negative. If the ten transactions were cleared in the order in which they were presented to the institution, the account holder would have overdrafted once, when the $600 rent check was posted, paid one $34 overdraft fee, and had a total negative balance of $177. If, instead, the institution manipulated the transactions to post them high-to-low, the account holder would have been charged eight $34 overdraft fees, totaling $272, and ended up with a negative balance of $415.[140] This illustration is attached to these comments as Appendix C.

Second, the injury is not reasonably avoidable by the consumer Account holders currently have no control over the order in which institutions clear transactions, and they have little knowledge of it either. Institutions' disclosures about the order in which they clear transactions are not revealing enough to provide account holders guidance. In fact, the ABA has argued that communicating clearing practices clearly to account holders is next to impossible for banks.[141] In reality, institutions are vague because they don't want to disclose that they clear transactions in whatever order maximizes overdraft fees. But in any event, account holders cannot be expected to predict this, when intuitively they will usually assume that transactions are posted in the order in which they occur.

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[138] *See*, *supra*, note 132 and accompanying text.

[139] *Out of Balance*, *supra* note 30, at 6-7.

[140] *Id.*

[141] CFA Report, *supra* note 45, at 17 (citing Nessa Feddis, Senior Federal Counsel ABA, Letter to Jennifer J. Johnson, Secretary Board of Governors of the Federal Reserve System, Re: Proposed Interagency Guidance on Overdraft Protection Programs, August 6, 2004, at 6). CFA states, "The ABA contends that [the] order in which debits are processed is so complex that it is 'virtually impossible to explain in a manner understandable to most consumers' and would require several pages to disclose to consumers."

Third, the injury is not outweighed by countervailing benefits to consumers or competition. With respect to benefit to consumers, as noted above, industry asserts that customers appreciate their clearing transactions high-to-low because it better ensures that larger, presumably more important transactions are paid. However, this assertion is disingenuous in today's environment of fee-based overdraft programs that pay the vast majority of all overdrafts anyway. With respect to competition, institutions are not competing based on the order in which they clear transactions. The vast majority of institutions clear transactions high-to-low, so account holders have no real choice. Under the Agencies suggested proposal, account holders *would* have a choice, which would promote rather than inhibit competition.

The Agencies ask for comment on how a rule requiring institutions to pay smaller items before larger items when received on the same day would impact their ability to process transactions on a real-time basis. We would support required low-to-high processing as the Agencies suggest as well as real-time processing, i.e., processing transactions in the actual order in which they are received. For batch processing, institutions should be required to post the batches in the order in which they are received and to post transactions within each batch either low-to-high, real-time, or, with explicit conditions, how they are presented to the institution when they receive the batch. According to SHCU, its system allows it to choose the order in which the transactions within its ACH and check batches are posted. The options include (i) as received in file; (ii) highest to lowest; (iii) lowest to highest; and, (iv) for checks, in check number order. It also allows the credit union to choose to post all credits before debits. SHCU chooses that transactions be posted as received in the file, and also that all credits be posted before all debits.

SHCU receives its ACH batches directly from the Federal Reserve and its check batches from an intermediary processor, who first received those transactions from the Federal Reserve. Neither the Federal Reserve nor the check processor orders transactions within their batches from high-to-low. However, SHCU believes other institutions could arrange for their processors to provide their batches already ordered a certain way—i.e., high-to-low if they are trying to maximize overdraft fees. Therefore, in any rule on clearing practices, the Agencies should make clear that institutions may not post batched transactions in the order received within the batch if the processor manipulates the order—either by ordering debits high-to-low or placing all debits before all credits. The most practical way to do this may be to require all institutions to post transactions in the order in which they were provided by the Federal Reserve, regardless of whether or not they pass through an interim processor.

It is noteworthy that the Agencies have suggested an opt-in arrangement for transaction clearing processes. By suggesting that low-to-high clearing be the default arrangement, and allowing account holders to opt in only if they want a different set-up, the Agencies would design the default to protect against the high-damage abusive practice. While the rule would allow for the occasional unfortunate circumstance when an important payment doesn't get paid because the transactions were cleared low-to-high, the rule would protect account holders from the *abusive* nature of the practice and the *routine* nature of the injury. We urge the Agencies to adopt the same approach to their proposed opt-out rule for fee-based overdraft coverage—and to get the default right by requiring opt-in.

V. EFFECTIVE DATE[142]

The Agencies ask for comment on when any final rules should be effective and specifically ask whether a one-year time period is appropriate. We urge the Agencies to require that the rules be implemented as soon as they determine is reasonably practicable because the ongoing harm is tremendous. Allowing one year for implementation will permit institutions to charge account holders at least another $17.5 billion in overdraft fees, which will be paid mostly by people least able to afford them, driving them further into a debt trap and making it far less likely they will be able to escape.

CONCLUSION

We appreciate that the Agencies have brought greater attention to abusive overdraft practices, but we are concerned the Agencies' proposal will do little to curb the abuse. Because account holders are unlikely to alter the default, the Agencies must get the default right. The default should be the arrangement that minimizes consumer injury. The Agencies should also design their rule to best protect account holders in the large majority of transactions, where overdrafts cause far more harm than good, rather than the small minority of transactions where overdrafts may offer some benefit. The rule should provide account holders with a moment of affirmative choice, when they may select among lower cost alternatives or choose no coverage at all. We urge the Agencies to prescribe the far better solution for addressing unfair overdraft practices and require institutions to obtain account holders' affirmative opt-in.

If the Agencies wish to discuss these comments, please do not hesitate to contact us.

[142] 73 Fed. Reg. 28933.

Appendix A

CRL’s Opt-In Notice

CHOOSE HOW YOU WANT US TO HANDLE OVERDRAFTS

An overdraft can occur if you write checks, make ATM withdrawals, make debit card purchases, or have automatic transfers that use up more than the available balance in your account. **You can choose how we handle your overdrafts. Evaluate the options in Part I below, and make your choice in Part II.**

I. Your Options for How We Handle an Overdraft

Type of Transaction	Sample Overdraft Amount	Fee You Will Be Charged
1. Transfer from another account	$25	**$___** [+ other additional fees]
2. Line of credit	$25, paid back in 30 days	**$___** per transfer (Based on an annual percentage rate (APR) of __% on the amount borrowed [, plus a fee of $___ each time you use the line of credit].)
3. Transfer from credit card	$25, paid back in 30 days	**$___** per transfer (Based on an APR of __% on the amount borrowed, plus a cash advance fee of $___ per transfer, [plus a fee of __% of the amount of each advance].)
4. Fee-based overdraft	$25, paid back in 30 days	**$___** per item paid. If you repay the overdraft within 30 days, the equivalent APR would be __%.
5. Decline to have overdraft covered	You will not be allowed to overdraw your account.	**Debit card or ATM**: Transaction would be denied and you would not be charged a fee. **Checks/Electronic Transfers**: We would not pay the check and would charge you a non-sufficient funds fee of **$___**. [You may also incur a bounced check fee from a vendor.]

- We may charge you the fees above even if you spend only $__ more than you have in your account.
- [We can charge you a maximum of $__ in fees per day and $__ per statement period for spending more than you have in your account.] [There is no limit to the amount of fees we can charge you for spending more than you have in your account, per day or per statement period.]

II. Make Your Choice

Mark the box next to your choice. You can choose that checks/electronic transfers be handled differently than debit card/ATM transactions.

	Your Selection For: Checks / Electronic Transfers	Debit/ATM
1. Transfer funds from another account.		
2. Apply for a personal line of credit.		
3. Transfer funds from a credit card.		
4. Use fee-based overdraft to pay the item.		
5. Decline to have the overdraft covered		

_________________________ _________________________

Customer signature Printed Name

________ _____________

Date Account number

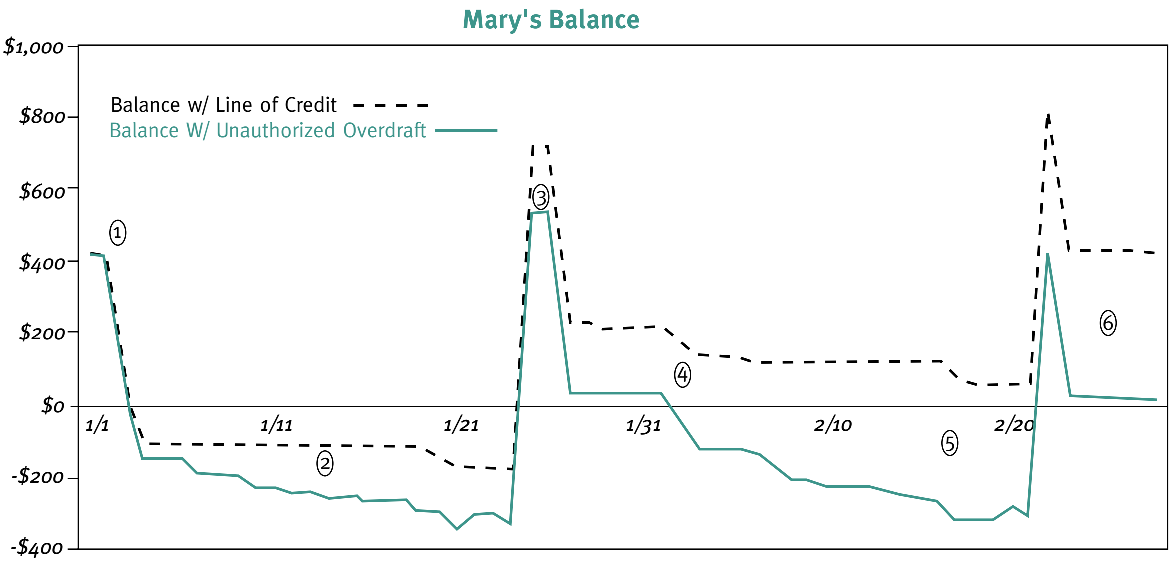
Appendix B

Real-Life Case Study

Case Study: A Social Security Recipient's Experience with Overdraft Fees

Our data allows us to recreate periods of time in a person's checking account activity, to provide snapshots of the broad trends in the data. Here, we track the checking account activity of a panelist (aka "Mary") entirely dependent on Social Security income for the months of January and February 2006.

Figure 3. Representation of account balance of panelist "Mary" January–February 2006



1: 1/3, Early-month expenses take Mary into overdraft

2: 1/9–1/20, Line of Credit maintains balance, while fee-based program accumulates daily fees, forcing a utility bill to be rejected on 1/20

3: 1/25, Social Security check brings Mary out of overdraft

4: 2/2, Accumulated fees from January force Mary back into overdraft; with a Line of Credit, she would have maintained a positive balance

5: 2/17, Daily fees mount again in February, forcing rejection of another utility bill

6: 2/28, By the end of February, Mary has just $18.48 for the next month in her fee-based overdraft program. With an 18% Line of Credit, she'd have about $420!

Mary begins the year 2006 with $420.56 in her checking account, held at a large national bank. She makes a $380 ATM withdrawal and several smaller point-of-sale purchases on January 3, comes up short, and is overdrawn by January 4. She incurs a $34 overdraft fee for the initial overdraft. After two more purchases, and two more overdraft fees, she finds herself almost $200 below zero on January 9.

For the next eleven days, Mary doesn't spend any money from her checking account, but her checking account loses money, nonetheless. Her bank charges her a fee of $7 a day because of her ongoing negative balance. By the time a scheduled electronic withdrawal is made to pay a bill for $32.38 on January 20, Mary's account is overdrawn by more than $300, and the bank rejects the transaction. Her bill goes unpaid, although the bank continues to charge daily negative-balance fees.

Finally, on January 25, Mary receives her monthly Social Security check of $904. However, her account is already $335 overdrawn and she still has an additional $500 in expenses for the month. Once these payments are made, Mary only has $31.09 left to live on until her next Social Security check comes in late February. Because of this, Mary almost immediately has a negative checking account balance again, once she makes three small ($20 or less) purchases on February 1. Over the next two days, Mary incurs two overdraft fees because of these purchases and conducts another transaction for $50, which also results in an overdraft.

If Mary's bank had instead offered her an 18 percent APR line of credit to cover overdrafts, she would have only paid about $1 in total fees for her overdrafts.

Mary does not make any more purchases between February 8 and February 17. However, the bank again continues to charge her a fee of $7 a day because of her ongoing negative balance. On February 18, an automatic bill payment causes Mary's account to go even farther into the red—a transaction that the bank approves even though her account is already below zero and she cannot even repay the $7 daily negative balance fee.

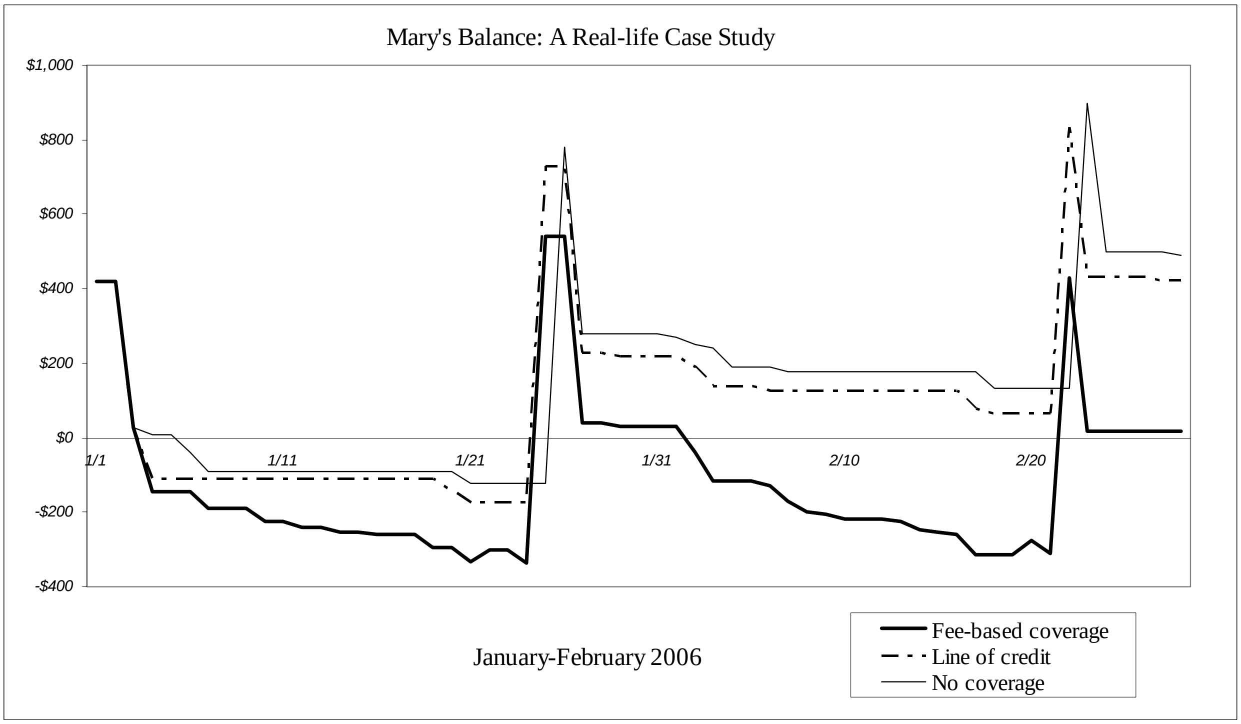
Once Mary's account dips to $314.91 *below zero,* the bank finally begins to refuse additional transactions, rejecting a utility bill for another month. The $7 daily negative balance fees continue to be assessed through February 21.

Finally, on February 22, Mary's Social Security check comes in, and the account balance ends up above $400 once the bank subtracts the overdraft fees. Unfortunately, because Mary still has to pay her end of the month expenses totaling about $410, she is left with only $18.48 to tide her over until the end of March. This meager sum—even less than the $31.09 she had to make ends meet after being charged for overdrafts in February—virtually guarantees that Mary will continue to remain trapped in a cycle of accumulating overdraft fees month after month.

In January and February, Mary paid $448 in overdraft fees in return for receiving $210.25 in credit from her bank, and was forced to live on $20 from a Social Security check of nearly $1,000. If Mary's bank had instead offered her an 18 percent APR line of credit to cover overdrafts, she would have only paid about $1 in total fees for her overdrafts.

In the figure on page 9, Mary's account balance is shown in green, and her account balance had *she been enrolled in an 18 percent line of credit* is shown in black and dashed. By the end of the two months with a line of credit, Mary's balance would have been $420, more than enough to meet her remaining expenses until the next Social Security check. In addition to this, her payments to the utility company would have been approved because her account would not have been over $300 overdrawn, thus saving her non-sufficient funds fees and keeping her utility account current. Most importantly, the cycle of having the bulk of her monthly income stripped away to repay high overdraft fees, leaving little to use for the current month's bills—and therefore making Mary more vulnerable to incurring yet more overdrafts—would be broken.

The following graph is identical to the one on page 14 of these comments. It adds a third scenario—no overdraft coverage at all—to the graph discussed on the preceding two pages of this appendix.



Appendix C

Illustration of the Effect of High-to-Low Transaction Clearing

Manipulation of check ordering and debit clearing[1]

Another practice that can increase bank revenue from overdraft fees is that of manipulating the order that checks or debits clear a customer's account so that higher amounts clear before lower amounts. Since abusive overdraft loan fees are assessed as flat fees per incident regardless of the dollar value of the loan, consumers may pay more in fees if their largest transactions go through first.

Financial institutions' clearing practices differ, but their written policies reserve the right to pay in the order they choose, and not necessarily in the order in which payments were made.

For example, US Bank's policy states:

> **Our Options:** When an item of yours overdraws an account, we can either pay or refuse to pay the item.
>
> If we get a **batch** of such items in a day (checks typically come in batches), and if one, some or all of them would overdraw the account if paid, we can pay or refuse to pay them, in any order, or no order. For example, if one large check and six small checks are offered to us for payment, and the one large check would empty the account, we can:
>
> (1) pay the one large check and refuse to pay the six small checks;
> (2) pay the small checks and refuse to pay the large check;
> (3) pay all of them, creating an overdraft; or
> (4) pay some and reject others.
>
> We have all these options each time you might overdraw an account. What we do one time does not make that a rule you can rely on for the future.[2]

For an illustration of how this could play out, assume an account holder has $750 in her checking account. Before she realizes she is not covered, she pays some bills and makes some small dollar purchases, putting her $143 in the negative.

The order in which these payments clear her checking account makes a big difference in the cost of that shortfall. If the payments were presented to the financial institution on the same day, in the order in Scenario A below, and if they were cleared in the order they were presented, she would be charged like this:

[1] This appendix is an excerpt from Eric Halperin and Peter Smith, *Out of Balance: Consumers pay $17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending, at 5-7 (June 2007), *available at* http://www.responsiblelending.org/issues/overdraft/reports/page.jsp?itemID=33341925 (last visited Aug. 4, 2008),

[2] US Bank, *Terms and Conditions for Deposit Accounts*, effective October 15, 2006. Available at https://fastapp.usbank.com/fastapp/en_us/termsAndConditions/TandC/LinkDepositAgreementCurrent.jsp), last viewed June 20, 2007.

Scenario A: Chronological Ordering of Charges

Transaction	*Charge*	*Account Balance*	*Average Overdraft Fee*
		750	
Credit card payment – ACH	90	660	
Water bill - check	30	630	
Groceries purchase – debit card	65	565	
Gas purchase – debit card	25	540	
Lunch purchase – debit card	10	530	
Drugstore purchase – debit card	15	515	
Family gym fees– check	40	475	
Coffee purchase - debit	8	467	
Bookstore purchase – debit card	10	457	
Rent – check	600	(143)	$34
TOTAL OVERDRAFT LOANS		**$(143)**	
TOTAL OVERDRAFT FEES			**$34**
Balance with fees deducted		**$(177)**	

On the other hand, if the payments were cleared from the largest to the smallest, the amount by which her account was overdrawn would remain the same, but the charges would be significantly higher.

Scenario B: High-dollar Ordering of Charges

Transaction	*Charge*	*Account Balance*	*Average Overdraft Fee*
		750	
Rent – check	600	150	
Credit card payment - ACH	90	60	
Groceries purchase – debit card	65	(5)	34
Family gym fees - check	40	(45)	34
Water bill - check	30	(75)	34
Gas purchase – debit card	25	(100)	34
Drugstore purchase – debit card	15	(115)	34
Lunch purchase – debit card	10	(125)	34
Bookstore purchase – debit card	10	(135)	34
Coffee purchase – debit card	8	(143)	34
TOTAL OVERDRAFT LOANS		**$(143)**	
TOTAL OVERDRAFT FEES			**$272**
Balance with fees deducted		**$(415)**	

Banks and credit unions claim that their overdraft programs are providing customers a service—protection from returned check fees. But this argument is disingenuous, because in either scenario above, all the transactions are paid. The only difference is that in Scenario B, the bank or credit union increases their fee income by manipulating the order in which they clear the payments.

Of course, if the bank customer had no overdraft program in place at all, her rent would likely be paid late. But even if her landlord charged her a late fee of $30 (five percent of the rent) and her bank charged an NSF of $20, for a total of $50, she would still come out better than she would under Scenario B, which cost her $272.