

January 27, 2003

Ms. Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551
Via email: regs.comments@federalreserve.gov

Re: Regulation Z; Docket No. R-1136 and “Bounce Protection” Programs;

Ladies and Gentlemen:

We, the undersigned individuals and organizations, are pleased the Federal Reserve Board has requested comment on fee-based overdraft programs (“bounce protection programs”), because we believe they are a hidden and unfair tax on the most vulnerable depositors. We have two specific suggestions regarding these programs:

1. Revise Regulation Z and fair lending regulations to require financial institutions offering fee-based overdraft programs to treat such charges as extensions of credit; and
2. Revise Regulation DD to exclude from the definition of “free checking” those accounts with fee-based overdraft programs or that increase the number of checks subject to NSF fees by paying larger checks first.

Much has been written about “payday lending,” a highly abusive practice that federal bank regulators as well as many state regulators have begun to crack down on. Payday lending encourages lower income people to obtain an advance on their next paycheck, at APRs of up to 500% or more.

Unlike payday lending programs, the extraordinarily high APRs in fee-based overdraft programs are never disclosed as such, and none of the other consumer credit protections are provided. Moreover, fee-based overdraft programs are aimed at the very same customers that payday lenders are seeking: low and moderate income account holders with little or no savings. The source of repayment is the same (the next paycheck), and the costs rival or exceed those of payday lending. In addition, with fee-based overdraft programs, the depositors face multiple costs in a payday cycle (that is, on each overdrawn check) rather than one-time costs (that is, on a single payday advance).

Perhaps it would be useful to describe how these fee-based overdraft programs typically work. First, consulting firms aggressively sell the programs, with promises of significant profits. We’d urge the Board staff to look at some of the firms’ own web sites, such as Strunk & Associates at <http://www.strunklp.com>.

Second, the banks typically identify segments of their customer base that are most likely to be in an overdraft situation, or may be encouraged to be in an overdraft situation. The bank then recruits these customers with promises of “free checking.” The Federal Reserve’s own Regulation DD inadvertently encourages this bait-and-switch, since a checking account can be called “free” under Regulation DD so long as there is no minimum balance, and even though the account may be structured with the purpose of charging a huge amounts of fees. Indeed, note in the Strunk web site referred to above how the financial success of fee-based overdraft programs is typically linked to “free checking.”

A bank maximizes the overdraft fees in at least three ways. First, it makes sure the program falls below the radar of Regulation Z and other consumer protection laws by arguing the programs are only incidental accommodations, and thus not “credit.” Second, the bank often sets its computer to pay larger checks first, thus depleting the consumer’s account as fast as possible and causing a fee on each subsequent check paid that day and in future days. If the program were intended as a true consumer accommodation, the logical approach would be to pay the lower amount checks first, and then pay the larger checks (maybe only one or two) as an overdraft. All of the checks would still be paid, but the cost to the consumer would be far less.

Third, many banks now permit disbursement of cash at ATMs even when there are insufficient funds in the underlying accounts, and they do so without telling consumers they will have to pay a fee that, expressed as an APR, would typically be 1,000% or higher.

Here is an example of how such an APR arises. Assume the customer's account has an \$80 balance and that the overdraft fee is \$21 per overdraft (a conservative estimate, since many of the overdraft fees are now \$25, \$30 or more per overdraft). The customer goes to an ATM and asks for \$100 in cash, which is paid, leaving a minus-\$20 account balance. If the customer pays the \$20 back together with the \$21 overdraft fee at the end of one week, the annualized interest rate is 5,475%; if she pays it back at the end of two weeks, it is 2,738%. (An overdraft fee of \$30 would result instead in APRs of 7,821 % and 3,911%, respectively.)

Payday lenders never dreamed of such returns. And even if a customer repeatedly overdraws an account, most of these banks will continue to offer the "accommodation," and they will do so even when the customer fails to repay the overdrafts within the permitted time periods. These are the customers who create the most fee income for the lender, and the ones who can least afford to.

Most responsible banks in fact provide their customers, no matter what their income levels are, with responsible overdraft programs. These banks provide overdraft as a true form of credit through a linked credit card or other line of credit, or through a savings account transfer. These legitimate programs are fully disclosed to consumers and, when the programs involve credit, they are subject not only to Regulation Z, but also Regulation B and other consumer protection laws. And, of course, these programs employ proper underwriting criteria to assure that consumers are not coaxed into an amount of credit above what they can properly handle.

It is the banks with irresponsible programs that we are concerned about here, because they steer low and moderate income customers (that is, the most vulnerable part of their customer base) to free/fee checking, and then maximize the overdraft and other fee opportunities of these accounts. These programs constitute an insidious and rampant form of predatory lending, and this is an opportune time for the Federal Reserve to address the issue.

We urge the Board to recognize these fee-based overdraft programs for what they are - predatory consumer lending - and provide the appropriate protections under applicable laws. We believe that the Board should amend Regulation Z to treat fee-based overdraft programs as extensions of credit, and we would urge that it similarly amend Regulation B and related fair lending regulations to cover these programs. Finally, we urge the Board to address the abuses that are taking place under Regulation DD's outdated definition of "free" checking.

Sincerely,

Organizational Signators

Association of Community Organizations for Reform Now (ACORN)

Mark Pinsky, President and CEO, National Community Capital Association

John Taylor, National Community Reinvestment Coalition

Margot Saunders & Elizabeth Renaurt, Attorneys, National Consumer Law Center

Shanna L. Smith, National Fair Housing Alliance

Mary Mountcastle, Center for Responsible Lending, North Carolina

Martin Eakes, Center for Community Self-Help

Ira Rheingold, National Association of Consumer Advocates

Malcolm Bush, The Woodstock Institute

Ed Mierzwinski, U.S. Public Interest Research Group (PIRG)

William Bynum, Enterprise Corporation of the Delta, Mississippi

Shelley Alpern, Trillium Asset Management Corporation
Bob Radcliff, Capital District Community Loan Fund, Albany
Susan Vickers, Catholic Healthcare West
David Marzahl, Center for Economic Progress
Louise Trubek, Center for Public Representation, Madison, WI
Calvin Holmes, Chicago Community Loan Fund
Frank Coleman, Christian Brothers Investment Services, Inc.
Kerwin Tesdell, Community Development Venture Capital Association
Daniel Horvath, Community Enterprise Investments
Scott Ball, Community Housing Resource Center, Atlanta, Georgia
Peter Skillern, Community Reinvestment Association of North Carolina (CRA*NC)
Merrilee Witherell, Fair Housing Council of CNY Inc
Elsie Meeks, First Nation's Development Corp. and The Oweesta Fund
Sherry Salway Black, First Nations Development Institute
Larry Pellegrini, Georgia Rural Urban Summit
Terri Roeber, Housing Access Center
Moises Loza, Housing Assistance Council
Tony Lewis, Housing Association of Delaware Valley (HADV), Philadelphia
Arnold Cohen, Housing Community Development Network of New Jersey
Ron Elwood, Legal Services Advocacy Project, St. Paul, MN
David McMillin, Legal Services of New Jersey
Nancy Andrews, Low Income Housing Fund (LIHF), CA
JoAnn Kane, McAuley Institute, MD
Jim McCarthy, Miami Valley Fair Housing Center, Inc., Dayton, OH
Rodney Diller, MMA Trust Company
Tom Bledsoe, National Association of Housing Partnership, Washington, DC
Inez Killingsworth & Brenda LaBlanc, Co-Chairs, National People's Action
Dan Broun, NC Minority Support Center
Terry D. Simonette, NCB Development Corp
Sarah Ludwig, Neighborhood Economic Development Advocacy Project (NEDAP)
Phyllis Salowe-Kaye, New Jersey Citizen Action
Stella Adams, North Carolina Fair Housing Alliance
Julie Goodridge, NorthStar Asset Management, Inc.
Pamela Sah, NYC Foreclosure Prevention Task Force, Brooklyn
Channa Grace, Opportunities for Neighborhood Empowerment (ONE) Company
Jeff Hamaoui, Origo Inc
Scott Klinger, Responsible Wealth
Rachel Iskow, Sacramento Mutual Housing Corporation
Don Rounds, The Consumer Alliance (TCA)
Meizhu Lui, United for a Fair Economy
Roberto Barragan, Valley Economic Development Center (VEDC) Los Angeles (Van Nuys)
Irene E. Leech, President, Virginia Citizens Consumer Council
Kim Jacobs, Westchester Housing Fund

Individual Signators (organization listed for identification purposes only)

Debra K. Lumpkins, Attorney at Law, Hugo, OK
Elyse D. Cherry, Boston Community Capital, CEO
DeWitt Jones, Boston Community Capital, COO
Irv Ackelsberg, Community Legal Services, Inc., Philadelphia
Ken McEldowney, Consumer Action, San Francisco
Sister Patricia Marshall, Director, SBS Social Justice Office, Sisters of the Blessed Sacrament
Sr. Catherine Daly, Domus Corporation, housing affiliate of Catholic Community Services, Archdiocese of Newark
Ed Fulbright, Fulbright & Fulbright, CPA

Senator Vincent D. Fort, Georgia
Gary Klein, Grant & Roddy, Boston, MA
John Roddy, Grant & Roddy, Boston, MA
Greg Kirkpatrick, Habitat for Humanity of Wake County, NC
Nichelle Sims, Illinois Facilities Fund
Kenny Christianson, Ithaca College Dept. of Economics
Corinne Florek, Justice Organizers, Leadership and Treasurers (JOLT), Oakland, CA
Bernard Balsis, Kau Federal Credit Union
John Herrera, Latino Community Credit Union
Cory Smathers, Lincoln Action Program
Ben Mokry, Mississippi Home Corporation
Elizabeth Renuart, National Consumer Law Center
Judith Lichtman, National Partnership for Women & Families
Lanier Blum, NC Low Income Housing Coalition
Mary Mathews, Northeast Entrepreneur Fund, Inc., MN, President,
Ingrid Nelson, NYC Financial Network Action Consortium
Josh Zinner, NYC Foreclosure Prevention Task Force, Brooklyn
Jeanette Stokes, Resource Center for Women and Ministry in the South, Durham, NC
Joe Delclos & Cathy Semans, St. Ambrose Legal Services, Baltimore, MD
Ellen Schloemer, St. Raphael Catholic Church, Raleigh, NC
Dory Rand, Supervising Attorney, Community Investment, National Center on Poverty Law, Chicago
Mary Rogier, The Northern California Community Loan Fund
John McCullough III, VT Legal Aid
Lael Duncan, Western Lenders Network, Tonasket, Washington