



Consumer Federation of America

July 18, 2008

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Federal Reserve Board Regulation DD-Truth in Savings: R-1315

Dear Chairman Bernanke, Members of the Board, and Board Secretary Johnson:

Consumer Federation of America (CFA) appreciates this opportunity to comment on the Board's proposed changes to Truth in Savings Act (TISA) regulations that apply to overdraft loans made by financial institutions. The proposal in Docket R-1315 would change the form and content of disclosures under TISA and is a companion to proposed Regulation AA-Unfair or Deceptive Acts or Practices (R-1314) which applies to overdraft loans. CFA is joining the Center for Responsible Lending in its detailed comments on the proposed Regulation DD changes.

In addition, Consumer Federation of America requests that you consider our serious concerns about the Federal Reserve Board's failure to protect consumers who inadvertently and without informed consent borrow from banks when overdrafts are honored for a fee. Current rules and "best practices" guidelines and the proposed changes to TISA rules will not protect consumers from high cost overdraft borrowing.

Overdraft Loans are the Bank Version of Payday Lending

Credit extended by banks that pay for transactions that exceed the balance in a consumer's account bears striking similarities to predatory payday lending.

- In both transactions, cash-strapped consumers borrow small sums to be repaid in one balloon payment out of the next paycheck. A typical payday loan is around \$350. A typical overdraft loan, triggered by a debit card purchase, is less than \$50. Payment is due in full within just days and certainly not beyond the next deposit into the borrower's account.
- Loans are made without determining ability to repay. Payday lenders and banks do not run credit checks on borrowers or ask questions that determine ability to repay. Borrowers are most often low to moderate income consumers who struggle to make ends meet.

- Loans cost triple or quadruple digit interest rates. For example, a \$100 overdraft charged a \$35 fee and repaid in one week costs 1,820% APR. A \$300 payday loan costing \$45 finance charge and repaid in one week costs 780% APR. Payday lenders have to disclose the APR for their loans. So do other high cost small loan providers, such as outlets making pawn loans, tax refund anticipation loans, car title loans, and small installment loans. Banks don't have to provide comparable cost of credit information.
- Lenders collect payment by preemptive claim on the borrower's next paycheck, pension, benefit or exempt funds deposit. While payday lenders cash checks held for future deposit or use electronic access to accounts to withdraw payment in full (or get borrowers to pay to flip the loan to prevent the loan check from bouncing), banks use their right of set-off to deduct loan principal and finance charges before the accountholder has access to the next paycheck or Social Security direct deposit. Banks deduct the full overdraft amount plus fees before consumers have access to their funds in the account.
- Both products often trap consumers in a cycle of debt. Due to the high cost, short term, and lender access to the means of collecting these debts, both payday and bank overdraft loan customers are likely to renew loans or trigger additional overdrafts.
- Both products are draining a fortune from the meager funds of banked consumers who struggle to make ends meet between paydays. Stephens Inc. claims that store and online payday lenders collected \$8.6 billion in fees last year. The most recent CRL estimate for overdraft loan fees is \$17.5 billion.

CFA has urged the Federal Trade Commission and Treasury to designate payday loans based on the next deposit of wages or benefits into a bank account as the modern equivalent of an unfair wage assignment. The Federal Reserve should take positive action by at least treating bank overdraft "payday" loans as an extension of credit subject to federal credit laws.

The Federal Reserve Has Chosen the Wrong Law to Regulate Overdraft Loans

As acknowledged by the Federal Reserve and most other federal regulators, a bank extends credit when it pays a transaction that overdraws a consumer's bank account.¹ Yet, the Federal Reserve has failed to apply to overdraft loans the nation's premier credit protection law, the Truth in Lending Act (TILA), which would provide consumers with comparable cost of credit disclosures, the right to affirmatively contract for this extension of credit accessed by a debit card, and the other protections that go with TILA, including private enforcement rights. Instead, the Federal Reserve persists in treating the extension of credit through overdraft loans as if this were a bank account fee for service under the Truth in Savings Act. As a result, consumers are harmed in the following ways:

¹ "When overdrafts are paid, credit is extended." Joint Guidance on Overdraft Protection Programs," Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation and National Credit Union Administration, February 18, 2005, page 7.

- Banks charge their highest loan rates without disclosing the comparable annual percentage rate, the fundamental cost comparison tool for all forms of credit. Despite repeated requests from consumer organizations, the Board has declined to apply TILA disclosure requirements to overdraft loans. This deprives consumers of important information to select among banks and other credit options and gives banks an advantage over other high-cost cash advance providers that are required to comply with TILA. Fed rules allow banks to charge their customers the highest rates for loans without providing accurate cost information.
- Conditions for the Reg Z loophole the Fed carved out for bank overdraft loans (TILA disclosures not required as long as there is no contract to pay overdrafts and the bank charges the same fee as bouncing a check) have resulted in loans made without a clear and predictable agreement that a bank will or won't cover an overdraft, and with outrageous fees for small extensions of credit since the overdraft loan fee must equal the insufficient funds fee.
 - As a result, the finance charge for a cash advance loan is artificially tied to the penalty fee for bouncing a check.
 - Consumers get no contractual guarantees that a bank will reliably pay overdrafts and do not know which transactions will or won't be covered. A bank should not be permitted to conduct an overdraft loan program without making a commitment to cover overdrafts up to an agreed limit.
- Consumers do not get the right to choose to borrow under the bank's overdraft loan program. TILA requires consent to a contract to use credit extended on a card. TISA does not. While banks are forbidden by TILA from mailing an unsolicited credit card, banks are free to unilaterally turn a debit card into a credit card without warning or consent. Banks are not required to warn consumers when a debit card or ATM transaction will trigger an overdraft loan, to disclose what the fee will be or give customers the opportunity to cancel the transaction. By persisting in regulating overdraft loans as a bank "service" and offering only an opt-out plan under the proposed UDAP rules, the Board is undermining consumer sovereignty and providing banks a windfall in fee revenue.
- Consumers have no ability to enforce the modest protections provided by TISA. While Truth in Lending provides a private right of action and damages for violations, there is no private right of action under TISA. As a result, compliance is only a function of bank goodwill and regulatory oversight. Given the GAO report finding of widespread noncompliance with current TISA disclosure requirements, there is no reason to expect that additional TISA rules contemplated in this docket will have much impact.² GAO investigators were

² GAO: "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts," January, 2008.

often unable to get required bank account fee disclosures at bank branches visited or at some banks' web sites.

- GAO surveyors were unable to get a comprehensive list of fees from 22 percent of the 185 branches visited.
- GAO surveyors were unable to obtain terms and conditions for accounts from 61 of 185 branches or 33 percent of branches visited.
- GAO was unable to obtain a comprehensive list of fees from 51 percent of bank websites. They could not find terms and conditions posted for 66 percent of banks. Only 41 percent of banks posted their overdraft fees on their websites.
- The Report noted that federal regulators do not determine whether consumers actually receive TISA-required disclosures. Examiners only look at a sample of disclosures, not branch activity in making those disclosures available to consumers before they open an account.

CFA staff and volunteers attempted to collect bank fee schedules and account agreements early this summer to get up-to-date information on the order in which banks process withdrawals and the cost and terms of overdraft products. Our experience mirrored the GAO staff. One major bank refused to provide this information until the surveyor proved he was an existing bank customer. If banks routinely ignore TISA information requirements now, why would we think banks would risk their \$17.5 billion overdraft fee revenue by clearly providing information under the proposed Reg DD changes?

Although CFA has joined with CRL in providing constructive comments to the proposed changes in TISA Reg DD rules in this docket, we strongly urge the Federal Reserve to open a proceeding to apply Truth in Lending Act protections to overdraft loans. We appreciate the Board's interest in addressing bank overdraft loan issues and the proposals to extend disclosure requirements to all banks that charge overdraft fees. Thank you for considering our views.

Sincerely,

Jean Ann Fox
Director of Financial Services
Consumer Federation of America