S. HRG. 111–502

PROTECTING CONSUMERS FROM ABUSIVE OVERDRAFT FEES: THE FAIRNESS AND ACCOUNTABILITY IN RECEIVING OVERDRAFT COVERAGE ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE FAIRNESS AND ACCOUNTABILITY IN RECEIVING OVERDRAFT COVERAGE ACT IN ORDER TO PROTECT CONSUMERS FROM ABUSIVE OVERDRAFT FEES

NOVEMBER 17, 2009

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C O N T E N T S

TUESDAY, NOVEMBER 17, 2009

WITNESSES

PROTECTING CONSUMERS FROM ABUSIVE OVERDRAFT FEES: THE FAIRNESS AND ACCOUNTABILITY IN RECEIVING OVERDRAFT COVERAGE ACT

TUESDAY, NOVEMBER 17, 2009

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 3:07 p.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order. Senator Shelby, I have been notified, is not able to be here right now, but he wanted us to start and go ahead, and I appreciate that very much. And let me welcome our witnesses this afternoon to our hearing on "Protecting Consumers from Abusive Overdraft Fees: The Fairness and Accountability in Receiving Overdraft Coverage Act." That is a long title. There is an acronym in there someplace here for all of this. We appreciate your being here. We welcome the audience who is here as well. I welcome my colleague Sherrod Brown of Ohio, a Member of the Committee, and members of staff who are here and other members who will come in and come out. I should notify my colleagues as well that I am told there may be a vote around 3:45. What I will try to do is continue the hearing, and we will try and stagger people here so we do not interrupt the flow of this and allow our witnesses to be able to proceed. Senator Reed of Rhode Island has just joined us as well.

Let me begin with a brief opening statement after which I will ask my colleagues if they have any quick opening comments they would like to make, and then we will turn to our witnesses and hear from them, and then have a series of questions for you this afternoon regarding this bill and related matters.

I will begin by again thanking each and every person for being here this afternoon. Our job on the Banking Committee, this Committee, is to make sure that regular folks get a fair deal from their lending institutions and other financial institutions. The whole notion that depositors in a bank, people who buy insurance policies, people who buy shares in our public companies, people who have mortgages, all of those financial activities we have got to keep in mind as we talk about the stability of our financial institutions, the safety and soundness of financial institutions. It is also critically important to talk about the safety and security of consumers who depend upon these institutions serving their interests well. And this brings us to the subject matter this afternoon.

For too long, credit card companies have made tremendous profits—excessive profits, in my view—by charging consumers outrageous fees or raising rates whenever they felt like it, it seemed. Our Committee approved legislation to stop those abusive practices, legislation that passed the Senate earlier this year with overwhelming bipartisan support, and it was signed into law by President Obama later this spring, and we thank him for that.

Today we need to discuss another practice that I find in too many instances abusive, and that is, misleading overdraft programs that encourage consumers to overdraw their accounts and then slam them with too high fees.

Now, let us be clear. People have a responsibility. You begin there. It is a responsibility each one of us has to manage our personal accounts as well as we possibly can and to spend within the means that we have available to us. And banks have a right to charge a fair fee for legitimate services that they provide. To do otherwise would expect them to perform or conduct activities that would leave them disadvantaged.

But lending institutions often add overdraft coverage to consumer accounts without informing them or giving those consumers a choice in whether or not they want to have an overdraft fee or be notified, in fact, that they have overdrawn and allow them then to deal with it accordingly.

The overdraft charge is usually a high fee. A consumer can pay as much as a $35 fee for overdrawing on a $2 transaction, and we are going to hear specifically about just such a case this afternoon.

In some cases, a consumer can rack up multiple overdraft fees in a single day without ever being notified until days later that, in fact, they have overdrawn their accounts. Many institutions also charge additional fees for each day an account is overdrawn. The longer it takes you to realize there is a problem, the more fees, of course, you can be charged.

Sometimes banks will even rearrange the order in which they process your purchases, charging you for a later, larger purchase first so that they can charge you repeated overdraft fees for earlier, smaller purchases. So the truth is that the service of overdraft protection often serves as nothing more than a way for lending institutions to profit by taking advantage of their very own customers.

Last year, American consumers paid $24 billion in overdraft fees, and the *Financial Times* recently reported that banks stand to collect a record $38.5 billion in overdraft fees this year—almost double what they collected a year ago. According to the Center for Responsible Lending, nearly $1 billion of those fees will come from young adults; another $4.5 billion will come from senior citizens like Mario Livieri, one of our witnesses today and a resident of Branford, Connecticut. We thank him for being with us.

I will let Mario tell his own story about how an initial overdraft of $2 ended up in $140 overdraft coverage fees in just a matter of days. The method his bank used will sound familiar to many, many Americans. Families in my State of Connecticut and across the country are already struggling, of course, to make ends meet. We all know that, and these unfair and excessive charges are making it even harder on them.

Last week, the Federal Reserve, to its great credit, announced that they will require banks to get a consumer's consent before enrolling them in an overdraft coverage program. This was a welcome but long overdue announcement for American consumers, and we need to do far more to protect them from these abusive practices. And that is why I introduced the Fairness and Accountability in Receiving Overdraft Coverage Act. My colleagues Senator Schumer, Senator Reed of Rhode Island, Senator Brown, Senator Merkley, Senator Menendez, Senator Levin, Senator Reid of Nevada, and Senator Franken have joined us as cosponsors of this bill. And like the Federal Reserve's rule, our legislation would establish an opt-in rule for overdraft coverage for ATM and debit transactions. Customers would now have to consent before overdraft coverage is applied to their account.

Our legislation would go further, however, and limit the number of overdraft fees that banks can charge to one per month and to no more than six per year, and that fee would have to be reasonable and proportional to the cost of processing the overdraft. Our legislation would also put a stop to the practice of manipulating the order in which the transactions are posted and require banks to warn customers if they are about to overdraw their account, giving them a chance to cancel the very transaction they are about to engage in.

Finally, our legislation would require banks to notify customers promptly when they have overdrawn an account through whatever means the customer chooses—e-mail, text messages—so that they can quickly restore their balances and avoid unnecessary future fees.

Abusive overdraft policies are blatantly unfair, in my view, and the banks know it. After it came out in the press that I was working on this legislation, a few of the large institutions took their own steps toward responsible reform, I assume out of the kindness of their hearts, and I welcome it as well. It was a thoughtful thing to do.

Last week, the Federal Reserve released a new rule that will require banks to get a customer's consent before enrolling them in an overdraft coverage program. That is a very good start, and, again, I applaud them for doing so.

But our legislation goes further, and I remain committed to ensuring that American consumers are going to be further protected. And let us just remember, regulators did little while consumers were taken advantage of by these very misleading and unfair overdraft programs for years, despite the fact these regulators had the power for years to step in and put an end to these practices.

This is exactly why we need, in my view, an independent Consumer Financial Protection Agency that would be focused on preventing these abuses and addressing them quickly rather than having to wait week after week, month after month, for the Congress to pass legislation. It should not take that. Folks such as Mario Livieri deserve a lot better. He is one person here today, but there are literally millions like him across the country. And I remember committed, as my colleagues, I believe, do, to ensuring that American consumers are protected, and I look forward to our discussion that we are going to have this afternoon.

With that, let me turn to my colleagues. Senator Vitter, would you care to be heard on this at all for a minute or so? We are going to give our colleagues a chance to be here, and then we will get to our witnesses.

STATEMENT OF SENATOR DAVID VITTER

Senator VITTER. Thank you, Mr. Chairman. Thanks for holding this hearing, and I wanted to come by and offer a few thoughts. Unfortunately, I will not be able to stay for the entire hearing.

This is an important topic, and I am sure there are abuses in this area of banking. I am very concerned, however, as Congress often does, that we are going to push the pendulum to another extreme and create problems—perhaps as we are solving others, but create other problems. I believe that happened with some aspects of the credit card legislation. I would rather it not happen here.

In particular, I am concerned about closing certain services and opportunities to consumers and also shifting the cost that should be borne by consumers, depending on their behavior, to consumers more broadly. I am very concerned about that. It seems to me there is no way that this legislation, as it is currently drafted, would do that since, as the Chairman just said, it sets a limit on overdraft charges and fees no matter what a particular consumer's practice is, no matter what number of overdrafts may happen.

Now, it seems to me if that is the case at the end of the day, then we are going to shift costs from less responsible consumers to the entire class of consumers, including those who act more responsibly. And I do not think that is the proper direction to move in.

I would hope we can focus on real problems and real abuses and close those without that massive cost shifting and without closing the door of certain opportunity and service to consumers who may want them.

So those are my thoughts and concerns going into the process at the front end, and I look forward to working with the Chairman and the entire Committee as we move forward. Thank you, Mr. Chairman.

Chairman DODD. Well, Senator, thank you. Actually, you raise very legitimate issues, and that is why we have hearings like this, to hear these ideas and thoughts, and I welcome them. So I thank you for raising them. You will not be surprised to hear it is not the first time I have heard them, as have others who have expressed those very concerns as well, so I appreciate your bringing them up.

Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman, for convening this hearing and for your leadership on this issue. Thank you all, to all five members of the panel.

I am proud, as Senator Dodd is, to be an original cosponsor of the FAIR Overdraft Coverage Act. We need this bill because too many Americans pay too much for a service that is supposed to be a courtesy. When I think of the nearly $24 billion in overdraft fees

Americans paid last year, $900-plus million in my State of Ohio alone, "courtesy" is not the word that comes to mind.

Fees generated from this so-called "courtesy" have been growing by leaps and bounds. The Center for Responsible Lending tells us the average overdraft fee was about $35. That means that if a woman in Toledo or a man in Akron purchases something and it is a few dollars short, they can be charged a fee 10, 20, 30 times the amount of the overdraft. One of the things we have to keep in mind is that these are real people, real families struggling, when banks are placing them deeper in debt by imposing high overdraft fees. They are people like Kerry from Toledo, who was overdrawn by $6, but ended up paying $113 in fees. If that were a loan, she would have paid nearly 1,700 percent in interest.

The Center for Responsible Lending reports that 93 percent of all overdraft fees are paid by only 14 percent of account holders, and these account holders are most often folks who have lower income, are often young, are often nonwhite. These are people like Charles from Wadsworth, Ohio, near Akron. A recent college grad who never paid an overdraft fee in his life until a couple months ago, his problem was that when he checked his balance through his ATM, the balance report he received did not deduct pending transactions. So while he thought he had $80 in his account, he only had $15. He paid for three items totaling less than $20, but when the bank reconciled the transactions, he had $80 in fees charged to him.

Overdraft protection loses its meaning if consumers are at greater risk with that protection than without it. Understanding the cautionary notes or words from Chairman Dodd and the comments from Senator Vitter that people need to be responsible, this is something that has just gone too far.

We need to pass the FAIR Overdraft Coverage Act, reduce the amount of these fees, and give consumers more control over their bank account.

In closing, I just want to share a frustration that I hear too many times from too many people in my State. People believe, rightly or wrongly, each of the following things:

They believe that our economy was almost brought to its knees because of the financial services industry. They see that Government bailed out the financial services industry. They see that many of the executives of the financial services industry get big bonuses. And they see people in the companies in the financial services industry charge these kinds of fees to generally working-class consumers. And that just doesn't—I just hope the people from the industry on this panel and others in the audience understand the frustration, fair or not in those assessments, understand the frustration that so many Americans have with how their Government is treating them, how Wall Street is treating them, and how banks—and I do not lay this at the feet of the community bankers, to be sure, but how banks are treating them and how their lives are going in these very tough economic times.

Chairman DODD. I thank the Senator for that comment, and we do not often enough draw the distinction between community banks and regional and large investment banks. And I always promise myself I am going to draw that distinction when we gather because it is important. To use the word "banks" across the board draws in an awful lot of people who, frankly, do a very good job and are far more customer sensitive in their behavior, so we thank you for those comments.

Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Well, thank you, Mr. Chairman. Thank you for holding the hearing, and I want to thank the witnesses, and I want to echo your comments about community banks. I was in Rhode Island yesterday, and the two largest participants in our SBA programs are community banks, not the big national and regional banks, and they actually have avoided some of the excesses, and they are well positioned to help out. So they are an example that should be emulated, and I think you are right to point that out.

I am pleased not only to be here today, but also to be a cosponsor of Senator Dodd's FAIR Overdraft Coverage Act. We are in the midst of significant financial reform legislation, and I hope we can include aspects of this bill in this legislation, if not pass it separately. The Federal Reserve has taken some steps, but I think we have to do more. And the legislation that Senator Dodd has proposed will do that, and I think it will provide a sense of opportunity, transparency, and choice for customers.

Senator Brown's comments about perceptions I think are absolutely right. I think most people had a suspicion as they saw during the first decade of this century that no real increases in income, yet financial executives were enjoying huge, huge paydays, and when they saw insurance deteriorating for working families, that the deck was stacked against them. And I think the more we learn about what happened in the financial situation, the more that suspicion is buttressed by some evidence about how, when large institutions get in trouble, they get help, but when families across the country need help with avoiding foreclosure or avoiding excess charges, it is their responsibility.

So I think this legislation is timely, appropriate, and extremely important. Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator.

Senator Merkley.

STATEMENT OF SENATOR JEFF MERKLEY

Senator MERKLEY. Thank you very much, Mr. Chair. And my mind goes back to our credit card discussion earlier this year. I had Maggie from Salem, Oregon, who had had a credit card account for about 15 years, always paid on time, could not believe it when she found out she had a late payment. So she called up her bank and said, "I always pay on time. I always pay at the same time. How could I possibly be late?" And the credit card representative checked and said, "Well, here is the thing. We got your payment on time, but if you will notice in the contract, we can sit on the payment for 10 days, and we did, and when we posted it, it is now late and you owe us a late fee."

And Maggie said, I think, the phrase that captures the sense of millions of Americans, she said, "How can that be fair?" And that is the same standard of reasonableness and fairness that we need to bring to this conversation.

I think any bank customer who finds out that their bank has reordered their transactions in order to multiply the number of overdraft fees that they are being charged would say, “How can that be fair?”

So certainly this is an important conversation. I am pleased to be a cosponsor, and I look forward to the testimony. Thank you.

Chairman DODD. Thank you very much, Senator. I appreciate that.

I am going to leave the record open for our other colleagues as well for any comments they may want to make, opening comments as part of the bill.

Now let me introduce our panel of witnesses. I have already introduced, in a way, Mario Livieri, who is a constituent, as I pointed out earlier. He has traveled here from Branford, Connecticut, and will testify before us with regard to his own personal experience. He and I have talked about this before. We met, actually, in Connecticut several weeks ago, and I thought his story was so compelling that he deserved a national audience for his story. So we thank you, Mr. Livieri, for being with us.

Jean Ann Fox is the Director of Financial Services for the Consumer Federation of America. CFA is a nonprofit association of 300 consumer groups, and Ms. Fox advocates for issues including financial services, electronic commerce, and consumer protection.

Frank Pollack is the President and CEO of the Pentagon Federal Credit Union, which has close to 1 million members and whose core membership comprises men and women of the Army, Air Force, Coast Guard, and Department of Homeland Security, and we thank you very much, Mr. Pollack for being with us.

John Carey is the Chief Administrative Officer for Consumer Banking in North America at Citigroup. He is responsible for external matters impacting his company’s business, including business practices, external affairs, and community, regulatory, and governmental relations, and we thank you very much, Mr. Carey, for joining us.

Michael Calhoun is the President for the Center for Responsible Lending, where he has held that position since 2006. The center is a research and policy institute focusing on consumer lending and protection.

Again, we are very pleased to have all of you with us today, and we thank you. And, by the way, your full opening statements and comments and any supporting information you would like the Committee to have will be included in the record.

So we will begin with you, Mr. Livieri. Again, we are very grateful to you. You have to pull that microphone close to you. It is right in front of you. And there is a button down there that should active the microphone.

Mr. LIVIERI. I got it.

Chairman DODD. You got it. You are all set. You are on.

STATEMENT OF MARIO LIVIERI, CONSUMER, STATE OF CONNECTICUT

Mr. LIVIERI. Good afternoon, Chairman, Senator Dodd, and esteemed Members of the Committee. My name is Mario Livieri. I am a senior citizen and live in Branford, CT. I am honored to be invited here today to share my story with you. I hope that it will help you do right by consumers like me, who have been treated unfairly and misled by their bank about overdraft fees.

Until a few months ago, I was a customer at a prominent bank in my town. I am no longer a customer there because I do not think they treated me fairly.

Over the summer, I wrote a check for $200. When the check was cashed, it overdrew my checking account by $2.17. My bank charged me a $35 fee for my $2.17 mistake. I had no idea I had overdrawn my account. If I had known, I would have immediately deposited money in the account to cover the overdraft.

But, instead, it took the bank over a week to notify me of the overdraft. By the time they finally got around to telling me my account was overdrawn, I had made a few other transactions with my ATM card totaling $100, and the bank charged me $140 in fees.

Now, I owned a small business—a building and lumber company—when I was a young man, and I had been in business for over 50 years. I am quite sure they would have never done this to me 50 years ago. And I know that it is important to stick to a budget. But I also know that you do not get anywhere in the world of business by treating your customers unfairly.

So I called the bank, and after a whole bunch of arguing, they agreed to refund one $35 charge, but insisted that I pay all of the other fees. I told them I did not think it was fair. They told me it was legal. As a matter of fact, the people that told me it was legal was the thrift institution in Washington, DC.

I have been in business too long for that to be an acceptable answer. If that sort of practice—running up ridiculous charges for an overdraft "protection" program I didn't even sign up for—is legal, it shouldn't be. And it certainly isn't fair.

I am glad my Senator, Chris Dodd, is doing something about it. And I am grateful to the entire Committee for the opportunity to discuss my story with you. There are a lot of folks like me in your States who are in the exact same situation. They make a little mistake and get slammed for it by their bank.

I hope that we can stop abusive overdraft coverage practices so that no one else, no matter what bank they use, has to go through what I went through.

Thank you for inviting me here today and thank you for fighting the good fight on behalf of us consumers. Thank you.

Chairman DODD. Mr. Livieri, thank you very much. I appreciate that.

Jean, we thank you for being here with us today.

STATEMENT OF JEAN ANN FOX, DIRECTOR OF FINANCIAL SERVICES, CONSUMER FEDERATION OF AMERICA

Ms. FOX. Thank you, Chairman Dodd and Members of the Committee. I am Jean Ann Fox, Director of Financial Services for Consumer Federation of America. I am testifying today on behalf of the national consumer groups listed on our testimony.

We enthusiastically support Senate bill 1799, the FAIR Overdraft Coverage Act. We also commend you for the proposal to create a Consumer Financial Protection Agency, which would not only implement the FAIR Overdraft Coverage Act, but also enforce the law and clamp down on all high-cost loan abuses. So thank you for doing that.

In docket after docket, the Federal Reserve has failed to protect consumers from abusive overdraft lending. The rule that was announced last week will be a help, but it is not sufficient to protect consumers from the abuses that are inherent to overdraft coverage by banks. Along with recently announced changes in big bank overdraft programs, the rules are too little, too late, to provide the reforms that American consumers need and want.

Banks extend credit when they pay a transaction that overdraws a consumer's checking account. Instead of denying a debit purchase at the point of sale or a cash withdrawal at the ATM on insufficient funds, banks permit this transaction to go through, loan the bank's money, and then the largest banks charge a typical $35 fee for the extension of that credit. These loans are not authorized by consumers. No consumer opts in typically on overdrafts that are provided as a "courtesy" by the bank. Consumers do not apply for these loans. They do not get truth-in-lending cost disclosures. They do not get a contract that the bank promises to cover overdrafts up to a certain limit. They do not get a warning when the transaction will trigger an overdraft and a fee. And their creditworthiness is not evaluated when this credit is extended.

These loans are for small sums of money. The FDIC study released last year found the typical debit card purchase overdraft was just $20, so banks are charging $35 to loan $20 for a few days. And the typical overdraft did not exceed $78 in the FDIC study. These small loans come at astronomical cost with bank fees up to $39, the highest we found in a most recent survey. Banks pile on extra fees if you do not repay in a day or two. The majority of the largest banks charge sustained overdraft fees. You can be charged $35 for your first $5 overdraft. If you do not pay that back in 5 days, it now costs you $70. And these overdraft loans are taken out of the next deposit into consumers' bank accounts, making the banks the first creditor who gets paid out of your next paycheck or your Social Security check deposited to your account. And these loans are extremely expensive. For the FDIC's typical $20 debit overdraft, if the fee is just $27 and you get a whole 2 weeks to pay it back, that is 3,520 percent APR, which leads us to describe bank overdraft lending as payday loans as done by banks.

These loans come with balloon payments. You do not get an affordable repayment schedule. These get paid first, which can cause other checks consumers have written to bounce and trigger more bounced check or overdraft fees. And banks use tricks and traps to drive up the number of transactions that will overdraw by ordering the largest withdrawals first so that that wipes out your balance, and then they can charge you overdraft fees on all the other smaller transactions.

This is not what consumers want to have happen. In polling that CFA did this summer, we found that 71 percent of American consumers say they want banks to get permission to cover overdrafts for a fee; 85 percent of Americans want banks to be required to disclose on the ATM screen if a withdrawal will trigger an overdraft; 70 percent say that banks should pay transactions in the order they receive them; and in polling done for Consumers Union, they found that consumers expect that if you do not have enough money to cover a transaction and you use your debit card, the bank will reject it. That is not typically the case.

The consumers who are trapped in overdraft are the ones who can least afford the most expensive form of credit that banks offer. About a fourth of bank customers paid the $24 billion in overdraft fees that were collected last year, and they are most likely young, low-income, and minorities.

I would be glad to answer questions later about the specific provisions of the bill, but let me wrap up by saying fee-based overdraft lending traps consumers in astronomically expensive debt and deprives families of money that they need to meet their basic needs. These are not a convenience. Overdraft loans are dangerous, high-cost loans that must be reined in, even for people who agree to use them. We urge this Committee to reverse the drain on vulnerable consumers' bank accounts by supporting Senate bill 1799.

Thank you.

Chairman DODD. Well, thank you very, very much, Ms. Fox. We are grateful to you for your testimony and support.

Mr. Pollack, we welcome you to the Committee. You are very gracious to be here today, and we are anxious to hear your perspective.

STATEMENT OF FRANK POLLACK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PENTAGON FEDERAL CREDIT UNION

Mr. POLLACK. Thank you, Mr. Chairman, and thank you to the Members of the Committee. On behalf of the board of directors and management of the credit union, I would like to thank you for this opportunity to testify today. As you mentioned earlier, we serve the military and Department of Homeland Security, and we are a conservative institution that is particularly fee averse. Our total fee income represents less than 10 percent of our total income in any given year.

While our first priority is to remain safe and sound, our strategic objective is to provide products and services that offer high rates on savings, low rates on loans, and low fees. We have been recognized in the military community as a leader with our overdraft protection programs. And we have always viewed overdraft protection as a particularly valuable service for the military member. In their line of work, maintaining good credit is important to their military readiness and ultimately their career. Thus, our program dates back more than 20 years, preceding most of the overdraft programs that have come into question today.

From the very beginning, we have believe that members should either qualify for our low-cost line of credit, or we should not allow overdrafting of their accounts. We would note that with more than two decades of experience, we find that our members are appreciative of that approach.

We offer a line of credit attached to a member's checking account with a minimum of $500 overdraft protection. This service is offered to every creditworthy member who opens a checking account. Forty-five percent of our active checking account members have such a line of credit. As a result, our programs have always been opt-in. We believe strongly that every consumer must have opt-in rights.

At the Pentagon Credit Union, we charge 14.65 percent annual percentage rate calculated on a simple interest basis with no other fees and charges for overdrafts. We believe that by using a line-of-credit product which is formally recognized as a loan and, thus, subject to all of the Federal lending disclosure requirements, the cost to the consumer is both fully disclosed and properly proportional to the amount that they overdraw their account by.

At PenFed, we post transactions smallest to largest to avoid charging unnecessary overdraft and nonsufficient fund fees. We provide separate mail notifications for each overdraft event so that our members are kept fully aware of the status of their accounts. We believe that rapid notification is important to those members so that they can pay off their overdraft as quickly as possible.

In short, we have attempted to craft a product that is truly consumer friendly. We would make note of the fact that we have not received a single complaint from our membership regarding the order in which we process items in more than 20 years.

Nevertheless, there are members who do not choose to opt-in, and there are those who cannot qualify for a line of credit. These members are not allowed to overdraft their account with the limited exception of an offline debit transaction where we are required by contract to process such payments. In those instances, we do charge a $30 fee. This does not happen with great frequency, and we recognize that the proposed bill would eliminate that fee. We support that. We also recognize that the recent action of the Federal Reserve Bank will prohibit such a fee. However, we do believe that merchants and networks should be required to process all transactions in real time, which would eliminate this exception circumstance.

As an organization, we are constantly focused on process improvement. We felt that there was more that we could do for our military members in the area of overdrafts. This summer, we made a decision to eliminate as many of the nonsufficient fund fees that our military members incur as we possibly could. The product we created is called "Warriors Advantage." It waives the checking account fees associated with instances of insufficient funds for up to two occurrences in any rolling 3-month period. Importantly, this program is separate and distinct from our overdraft line of credit and goes beyond the minimum requirements of the proposed legislation.

Under this program, a military member without overdraft protection can use all of the money available in their checking, plus their line of credit, and still have two additional instances of return items every 90 days with no fee or charges beyond the interest on their loan. Our research indicated that this program would result in just over 98 percent of our military members with checking accounts never experiencing a fee. The Warriors Advantage program represents only a beginning for us. We intend to extend this program to our entire membership, and we are already at work on our next version, which we hope to roll out in the summer of 2010.

So thank you very much for this opportunity to testify. We are indebted to you for the work that you are doing on behalf of the American consumer.

Chairman DODD. Mr. Pollack, we thank you very, very much.

Mr. Carey, we welcome you to the Committee. I want to point out, we say this to you because oftentimes we have these discussions and hearings and people like Citibank and others are the subject of our concerns, to put it mildly, but I would like it to reflect here that Citi, overdraft fees from ATM and point of sale, PIN transactions, and debit transactions, when there are not sufficient funds in the account, real-time posting of debit and ATM transactions are part of Citi's program. So we compliment Citi for those actions. Because we do often sit here and berate you for what you are not doing, I want to compliment you when you do something right. So I want that to be reflected.

STATEMENT OF JOHN P. CAREY, CHIEF ADMINISTRATIVE OFFICER, CITIBANK NA

Mr. CAREY. Well, thank you, Senator. I appreciate it. Thank you very much for the opportunity——

Chairman DODD. There are still other things I want you to do. You are not off the hook.

Mr. CAREY. I understand that. I understand that.

Thank you very much for the opportunity to talk about the bill and to offer some recommendations for improving the choice with overdrafts.

You know, we have heard today that the policies that some of the banks employ in applying their overdraft protection, particularly with ATM and debit transactions, can be very confusing, frustrating, and often expensive for consumers, especially for those people who don't manage their daily finances that closely. There are many stories that we have all heard where a consumer incurred an unexpected fee for a transaction that could easily have been avoided had there been better information at the point of sale. It is the $5 cup of coffee that ends up costing $40 after the overdraft fee is slapped on.

So at the outset, it is important for me to be clear, and Senator, I think you have made it very clear, is that at Citi, we help customers avoid overdraft fees. We have never authorized—never authorized—ATM or debit transactions if we know the money is not there. And therefore, we do not charge an overdraft fee when a customer attempts such a transaction.

Moreover, through incentive programs with our personal bankers, we encourage our customers at the account opening and throughout their relationship with us to link a savings account or a line of credit to cover potential overdrafts and avoid either an overdraft fee or a bounced check fee. This practice is one of the best ways to reduce the risk and the costs of overdrafts.

Separately, we do allow overdrafts for checks and ACH transactions. We do this because the situation is very different. With checks and ACH transactions, customers have the sole control over the transactions. We cannot know what amount they are writing on the check or exactly when the check was written. In those cases, we mitigate risk for our customers and ourselves by allowing customers a cushion to cover a small overdraft. Further, in order to avoid large overdraft situations, Citi will not authorize a payment beyond a reasonable amount.

Today, fewer than 20 percent of Citibank customers are charged even one overdraft fee a year. Of those, only a few are charged more than once annually. We think that the reason for this is because we decline ATM and debit transactions when the funds are not available.

While we have concerns with aspects of the bill, we fully support the goal of protecting consumers from unnecessary overdraft fees. We support the additional efforts to improve consumer awareness regarding overdraft protection and alternative payment options. Moreover, we agree that banks should provide more transparent and easy-to-understand disclosures so that consumers can better manage their own money. We believe in the importance of giving consumers the ability to make choices based upon their individual circumstances as they manage their finances from 1 day to the next. That is why we believe there are opportunities for reform to provide consumers with even greater choice and control related to overdraft fees.

Of course, most consumers do not overdraft and never will. Still, consumers may not fully understand the effect of opting into or out of overdraft coverage will have on them over time. In the future, they may find themselves in the circumstance where they wish they could proceed with a specific transaction, even if they know they would be charged a fee. I am not referring to the $5 cup of coffee that ends up costing $40, but rather, it is about someone being stranded without cash in a foreign country and being able to access $100 from an ATM even if it costs them $135. Having previously opted out would eliminate the flexibility.

So it is our position that consumers should be given the choice of opting in at the point of sale. The choice and control should lie squarely in the hands of the informed consumer. So consumers should be alerted at the ATM or debit terminal that the transaction will overdraft their account and they should be able to choose at that moment whether or not they want to incur the fee and have them go forward with the transaction. In the absence of the choice, perhaps the transaction should be denied.

Understandably, updating the technology to provide such transparency will take time and it will be incumbent upon the merchants, the networks, and the banks to help create this functionality at the point of transaction.

With this point of transaction approach, all the issues in the bill about how many fees can be allowed, whether those fees are reasonable, exactly when the customer should be notified, and the other concerning policy and business implications of those points will all become moot. Informed consumers can decide whether a fee is too high or being charged too often based on their personal needs. In short, consumers need to decide.

As I have noted, we agree with the overriding goals of the bill. However, we have some important points of concern in the current bill that should be addressed. Some, I have noted here, and others in more detail in my submission.

I thank you very much for the opportunity to participate in this hearing.

Chairman DODD. Thank you very much. Very creative thoughts. We appreciate that.

How are you doing this afternoon? It is good to have you with us here today, as well, Mr. Calhoun, and we thank you for coming before the Committee.

STATEMENT OF MICHAEL CALHOUN, PRESIDENT, CENTER FOR RESPONSIBLE LENDING

Mr. CALHOUN. It is good to be here, Chairman Dodd and Members of the Committee. Thank you for your leadership in protecting consumers, especially enacting the CARD Act recently, and thank you for inviting us to testify today.

Nearly 5 years ago, Federal regulators studied overdraft fees and found serious problems. They issued joint guidance advising banks to consider prohibiting overdraft fees on debit cards and to limit the fees. Had this guidance been enforced, we would not be here today discussing the explosion in the amount and frequency of these fees. Instead, the regulators chose to not enforce the guidance, and in the intervening years, American families have lost an additional $70 billion.

Current overdraft practices are a pipeline out of the pockets of American families. Federal regulators have the present authority and duty to stop this abuse. Their hands are on the valve to cutoff the siphoning of consumers' money, but they refuse to cut it off.

I am going to focus my comments today on overdraft fees on debit cards, since this is the largest and fastest-growing source of overdraft fees.

Overdraft fees on debit cards are abusing and should be prohibited. It is a penalty fee totally unrelated to the cost, and the bank can stop the bank by doing as Citi does, just declining the transaction, and there is no NSF fee for the customer or the consumer when that is done. This is a little like a town with an intersection with a green traffic light, and then the town imposes a high fine on travelers who enter the intersection.

Today, banks manipulate bank accounts to generate fees and then oppose these high penalties. There are lower-cost alternatives, as have been mentioned today, but these abusive high fees are driving them out of the market. Several banks have discontinued alternative products, like lines of credit, because of the revenue from high overdraft fees.

Overdraft fees are turning debit cards into high-cost credit cards without the protection of CARD Act. These fees cause immense damage to families. More than 27 million families pay over five overdraft fees each year. It is taking families out of the financial mainstream, as we run into counselors who feel that they cannot tell families to get a bank account because these overdraft fees drive them into a financial hole they can't get out of.

These abusive overdraft fees also harm the banking industry and our overall economy. They disadvantage responsible programs who don't charge these fees, and it turns our banks into a competition of who can enroll the most customers in overdraft programs and then deplete their accounts rather than which bank can offer sustainable credit and fair financial services. One testimonial from a banker for overdraft programs went on to say, quote, "If I had two more products like this, I could quit making loans altogether."

We praise the reforms that are set out in S. 1799. It imposes critical limits on the amounts and number of fees. In contrast, the recent Fed consent rule is too little, too late. There was consent on credit cards before the CARD Act, but that did not solve the problem. Substantive protections were needed.

Again, overdraft abuses demonstrate the need for a Consumer Financial Protection Agency. If overdraft abuses had been a primary focus of an agency, they would not have developed in the way they have. There is a need for an agency that can act quickly and respond to new problems, and a Consumer Financial Protection Agency focused on consumer protection is best suited to do this.

It is said that to whom much is given, much is required. The American taxpayers have given hundreds of billions of dollars to the big banks, and taxpayers will pay for this for many years. It is not too much to expect that the recipients of this aid will use it to restore the American economy that they helped bring down, and at the very least, that these banks will not, in return, siphon away families' hard-earned dollars, hurting not only those families, but also the many businesses in dire need of the boost those dollars would provide if available to purchase useful goods and services.

We again call on the financial regulators, and especially the OCC, which oversees the biggest overdraft programs, to enforce the overdraft guidance sitting on their shelf and to issue regulations with substantive protections for American families. We also urge Congress to enact substantive overdraft reform, closing the gap in the CARD Act and putting an end to these abusive practices. Thank you.

Chairman DODD. Thank you very much, Mr. Calhoun, and again, I thank all of you for your participation today and your thoughts and ideas. They have been very constructive and helpful.

Let me, if I can, why don't we begin with you, Mr. Livieri, just a question or so. I was curious, and you and I have talked about this, but I wonder if you had received notice—we talked about this week that went by between the time you actually wrote that check for $200 and you only had $197.80, or close to 80 cents, in your account, and so you had $2.17 of an overdraw on that account. Would you have continued to use your debit card to make additional purchases had you been notified right away——

Mr. LIVIERI. Definitely not.

Chairman DODD. Yes.

Mr. LIVIERI. Definitely not.

Chairman DODD. I think you told me at one point that actually in the notice you received, that the postmark on the notice——

Mr. LIVIERI. The notice was given to me on the 18th and the postmark was the 24th. Then they sent me another one on the 16th, and the postmark was the 22nd. So I didn't know that I was overdrawn. As soon as they told me I was overdrawn, 10 minutes later or a half-an-hour later, I brought down money and everything was fine.

Chairman DODD. So it was 6 days after they actually took notice of it that they notified you?

Mr. LIVIERI. Correct.

Chairman DODD. Yes. And so had you been notified more promptly, you would have dealt with it. In fact, I hesitate to ask you this, but you have told me this, so I know the answer. You had enough money in your own accounts to more than cover these things.

Mr. LIVIERI. Oh, yes.

Chairman DODD. You weren't short that amount that was in the bank. You just weren't aware of what limited amount was——

Mr. LIVIERI. Was going on, right.

Chairman DODD. Yes.

Mr. LIVIERI. I didn't have it in their bank. I had it in another bank——

Chairman DODD. Yes.

Mr. LIVIERI. ——which was close by.

Chairman DODD. You are a multiple banker here. You are a——

Mr. LIVIERI. Well, no, but I didn't have it in their bank, but it was down the street a couple of blocks. So as soon as they told me that the thing was overdrawn, I just went and got the money and brought down cash to them.

Chairman DODD. Yes.

Mr. LIVIERI. So it wasn't a serious problem. Before this, on many occasions—because I was with this bank for 10 years—when I did something, and a lot of times it was their mistake, but if it wasn't, as soon as you put your card in and you put your PIN number and so forth, it would say "insufficient funds, go see your banker." It didn't this time. Nothing, like everything was fine. I mean, we are only talking $10.60, $30, and $20. That is all the things were for. It was not a serious amount. The only thing is the serious amount was the $35 to get $10.60.

Chairman DODD. So the technology existed in your bank where actually the machine notified you of insufficient funds?

Mr. LIVIERI. Sure. Yes. Sure.

Chairman DODD. That is interesting.

Let me ask the panel, if I could, Mr. Carey in his testimony talked about the frustrations that consumers express is centered on ATM and debit transactions where the overdraft coverage fees could have been avoided if the customer had only known at the ATM point of sale that the transaction would result in a fee. And I should let you know, in our bill, by the way, we ask for a study of this, to look at this particular point, so we have already accommodated your interest to some degree and recognize—although you heard from Mr. Livieri that actually the technology existed at his bank at an earlier time where they were able to notify him instantaneously——

Mr. LIVIERI. Correct.

Chairman DODD. ——about whether or not there was an amount—there was not an adequate amount of funds there to cover that particular transaction. But you make a good point, and as I say, we are evaluating it through a study.

But even if the technology were readily available at a reasonable cost, overdraft coverage fees should still be reasonable and proportional. You have got $2.17 and you have got a $35 fee. It seems to me if someone is overdrawn by $500, or $250, having an overdraft fee that would somehow be proportional to the amount of the overdraft would be more reasonable to me, at least. But the idea that even a few cents, where a person—literally, there are examples, plenty of these, where a cup of coffee or multiple transactions—young people particularly that are more inclined to maybe use that card more frequently and they have small transactions—where each transaction is at $35, or gets doubled that amount.

It doesn't seem that, at least in the interim, before we get point of transaction, that what we are trying to do here should be adopted rather than wait for all of that to occur.

Mr. CAREY. Senator, I guess the question is directed at me, so I will give it a shot.

Chairman DODD. OK, because you made the point——

Mr. CAREY. I made the point. That is fair. At Citi, at this point, if you were to go and buy that $4 cup of coffee and you did not have $4 in your account, we wouldn't authorize the transaction. Basically, the transaction wouldn't go through and the customer would have this decision to pull out another means of basically paying for it.

Chairman DODD. Yes.

Mr. CAREY. What we are essentially saying is that is what ought to happen until the technology is there at any point of sale, just to simply deny the transaction in its entirety and have the customer go someplace else or use some other mechanism to pay for it.

Chairman DODD. Right.

Mr. CAREY. That way, when you do that, when the customer literally—when this technology gets built, and it is not that far away because it can be done and it already is—it is in the ATMs, as we have heard—is you can make the decision about whether or not you want to incur the fee. Do I want this or do I not want this? No, I don't want the fee. I am willing to go someplace else to do that. And that is where the real choice is.

Chairman DODD. Right.

Mr. CAREY. My concern is that if we give a choice in a static environment, where I opened an account 2 years ago and I opted into this thing and I had no idea that I would be incurring this fee, that is the problem now.

You asked about the reasonableness of fees——

Chairman DODD. Yes.

Mr. CAREY. ——and it is a slippery slope. My concern about it is, certainly in the debit and the ATM space, establishing limits and establishing those, what is reasonable or not, I think that is worth discussing. But I think when we start talking about people writing checks and bouncing checks and the banks offering the service for overdrafts rather than having the check bounce, that is a good thing.

Chairman DODD. But my point, I guess, I want to make to you, that in the absence of these other matters being adopted, I wanted to determine whether or not you felt it was reasonable, our bill. I am not asking every dotted "i" and crossed "t"——

Mr. CAREY. No. In essence, what I would say, what I would suggest is that the transaction should just simply be denied.

Chairman DODD. Yes. Let me ask other members of the panel. Ms. Fox.

Ms. FOX. Senator Dodd, when banks talk about overdraft fees being set high to serve as a deterrent, that is a bit disingenuous. If they wanted to deter overdrafting, they would deny the transactions on debit cards at the ATM——

Chairman DODD. You anticipated my next question, because the GAO found that the average noninterest fees, including overdraft fees, increased by 10 percent or more since the year 2000. So how has the imposition of these fees as a deterrent fared if, indeed, recent data has shown increasing revenue coming to banks from these fees? It seems to me it is——

Ms. FOX. Right. We have been surveying the largest banks' overdraft fees for the last several years, and every time we go back and look, the fees have gone up. More banks are charging tiered fees, so the second and third and fourth overdraft is even more expensive. And now they are starting to add sustained overdraft fees, so you can get charged $35 immediately. If you don't pay the bank back in a few days, it is another $35. Some banks charge an $8 per day sustained overdraft fee.

I heard a young fellow in Indiana this summer, just out of high school, working a minimum wage job, and made a $10 math error on his bank account. He had four debit transactions that overdrew his account by $6.58. His bank charged $35 for each of them. He rushed down and deposited $100. That was sucked out to pay the overdraft fees, so he was still overdrawn, and they charged him $8 a day. By the time this young kid's family got in touch with me, he was $500 in the hole. That is not a deterrent. That is not a service. That is a debt trap.

Chairman DODD. Yes. Does anyone else want to comment on this before I turn to Senator Reed, or Senator Brown, excuse me? Does anybody else want to comment on this particular point?

Mr. CALHOUN. If I may add, that is what the practice was not many years ago, and that was a big selling point, in fact, of debit cards, was that they had a limit. They were different from credit cards. And again, what these overdraft programs have done, particularly with debit cards, is they have turned debit cards into extraordinarily high-cost credit cards——

Chairman DODD. That is a very good point.

Mr. CALHOUN. ——with none of the substantive protections. The CARD Act limits the number of fees and is patterned similar to what you have in S. 1799 and requires that those fees be reasonable, proportional, and they be consented to. If you are going to require that for a credit card, it seems like you need at least those protections when something is marketed as a noncredit product.

Chairman DODD. Thank you very much.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman, and thank you, Senator Reed.

A question for Mr. Calhoun and a question for Mr. Pollack. The American Bankers Association say that consumers appreciate having overdraft protection, that it is a service that their members' customers want. Why are your survey findings so different, Mr. Calhoun, from what the American Bankers Association tells us?

Mr. CALHOUN. Well, as many surveys, it depends what you ask and to whom you ask it. Our survey was done by an independent group, a larger sample nationwide, more than 2,000 respondents, and people want to know what it will cost them. When they are told $35, it is a whole different kettle of fish.

The other main thing is that for people who want it covered, there is an alternative, both a line of credit, which the typical charge if you use overdraft protection from a line of credit is less than $1 for an overdraft versus $35, or they used to regularly offer linking, as some still do, linking your debit card to your savings, and then some charge imposed, like a $1 fee each time you access it. Banks are discontinuing those programs because the regulators have allowed these abusive products to drive out the good ones.

So you can have—it is not an either/or. If somebody truly wants coverage for overdraft, they can have it and on a fair basis that is profitable to banks.

Senator BROWN. So 5 or 10 years ago, it would be much more likely for a bank to set up a situation that the account, the overdraft, if you will, would simply be money taken out of my savings account. There would be a link there. The bank would just do that automatically. I would get the statement that they had done that.

Mr. CALHOUN. Yes.

Senator BROWN. And that is much less common today than it was 5 years ago?

Mr. CALHOUN. Yes. If you go in, many banks no longer offer it and those that do often actively discourage it and point people toward the high-fee overdraft program instead.

Senator BROWN. Mr. Pollack, at the Pentagon Credit Union where you work, do your customers complain that you decline these debt transactions? Do you hear discussions from customers about this after they see how your system works?

Mr. POLLACK. Actually, we do not. We share the view, and we think that our members do, as well, that Citicorp has, that when they do not have money in the account, they prefer to know they don't have money in the account and not be charged a fee to get $20 or $5 for a cup of coffee. And so we have had no complaints.

Senator BROWN. You don't have the technology Mr. Carey talked about that someone is notified that they would be overdrawn but still has the option to be overdrawn and get the fee, pay the fee, in case of emergency? You don't have that technology, I assume, yet?

Mr. POLLACK. That is correct, and we reject if you do not have available funds.

Senator BROWN. As Citi, you said.

Mr. POLLACK. Right.

Senator BROWN. Would you know if most credit unions around the country have the policy that you have? Are other credit unions more likely to mimic the Pentagon Credit Union or are they more likely to mimic some banks that do this?

Mr. POLLACK. It is probably 50-50, roughly.

Senator BROWN. Can you—is it the larger credit unions that are more likely to do it? The smaller ones? Can you give me——

Mr. POLLACK. I think the larger ones are less likely to charge a fee. In the House meeting, the second-largest credit union showed up, which is North Carolina State Employees. They do not charge fees, either. So I think the larger credit unions are more apt to have programs similar to ours or similar to Citi's.

Senator BROWN. OK. Thank you. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman, and thank you, witnesses, for your wonderful testimony.

Let me ask, Mr. Carey, you have initiated these steps with respect to your policies as a result of any type of regulatory suggestion, or is this just something that you think is good business?

Mr. CAREY. This is something—this has been our practice really since we invented the ATM and that we have never done anything, literally——

Senator REED. Be careful, because somebody invented the Internet and got in a lot of trouble.

[Laughter.]

Mr. CAREY. I don't think there is much—not as much dispute around this one as, I think, the other one. But it has basically essentially been our practice, if the funds aren't there, the transaction doesn't go forward.

Senator REED. Well, the majority of banks, though, both large and medium and all sizes, charge these fees, and I guess my point is that do regulators ever look at you and say, that is great, or do they in any way sort of try to suggest what a good fee structure would be with respect to consumers, or do they just remain aloof?

Mr. CAREY. Well, I think to your first point, I have yet to be in a meeting with a regulator where they have said everything that I have ever done is really good and pat me on the head. I think that is not their job.

But, you know, they both through their compliance oversight as well as the safety and soundness oversight, they challenge us on all sorts of issues about how we are approaching specific things. I have not had specific conversations around our practices with respect to debit and ATM, but—nor would I expect to have them because, I think, it is not a driver of consumer complaints. They are not surprised that the coffee that they bought, in fact, cost them $40. And with respect to ACH and checks, our customers like the fact that we can cover off a transaction that is important to them rather than bouncing their check and having them face a returned, bounced check fee from a vendor and all the flow-down problems that come from it.

Senator REED. Thank you.

There is some evidence, though, I think, Mr. Calhoun, that consumers would rather be denied in some cases, and particularly debit cards, than to have automatic fees. Is that your findings at your agency?

Mr. CALHOUN. We polled and 80 percent of consumers prefer to be denied rather than impose the $35 fee on a debit. They want choice on all of these.

And going back to your question about the regulators, I think one of the really striking things is I mentioned the joint Federal guidance that was issued 5 years ago. That was February—almost 5 years ago, February 2005. But even going back further than that, the OCC, going back as far as 2001, was approached by a bank that wanted to offer one of these overdraft programs, kind of a new thing then, on debit cards, and it was very similar to the programs that have been described here today. In August 2001, the OCC responded in very harsh criticism noting all the lack of consumer protections and the program was never instituted at that time. Why the change of heart by the regulators? Consumers suddenly have more money that they want to pay in fees? Not only have they failed to address this problem, they have actively condoned the development of these overdraft programs, as your questioning was suggesting.

Ms. FOX. Senator, could I add to that?

Senator REED. Ms. Fox, please.

Ms. FOX. Also, the Comptroller of the Currency has had a set of guidelines for the order in which banks process payments, and none of those criteria add any consumer protection. It talks about deterring misuse of the account, or that the bank lets you overdraw. You haven't misused anything. You have been invited to do that. None of the OCC's guidelines about the ordering of payments says that consumers shouldn't be charged extra fees just because it has been manipulated. So the regulators have really failed to curb this practice. As the fees went up, overdrafts became more pervasive. More transactions became covered by it, and more money went out of people's pockets.

Senator REED. And that is, from your perspective, consistent across the board, not just OCC, but OTS and other——

Ms. FOX. Well, it is the Federal Reserve that writes the rules that implement the Federal banking and credit laws, and we have been urging them for years to require banks to comply with Truth in Lending when they extend credit through letting you borrow from the bank with an overdraft. And in docket after docket, the Federal Reserve has failed to do that. They have written Truth in Savings Act rules. They have now added rules to Reg E. But they have failed to provide a basic set of comparable protections to overdraft lending that every other creditor has to comply with.

Senator REED. And Mr. Pollack, you point out in your testimony that essentially that is what you do voluntarily, that because you treat, because of your practices, if someone has overdraft protection, you are consistent with all the lending laws and consumer protection laws, is that correct?

Mr. POLLACK. Yes, sir, that is correct.

Senator REED. And you have not seen that as an impediment to business or to profitability?

Mr. POLLACK. To the contrary. We are doing quite well.

Senator REED. Good. And Mr. Carey, just in my mind to clarify, your policy about debit cards is that you don't charge these fees, *et cetera*. With respect to checks, you do charge those, and unlike Mr. Pollack's organization, you don't do it through an overdraft, you do it automatically?

Mr. CAREY. Oh, no. We have, as I said in my testimony, we have programs similar to what Pen Fed has, which, again, at account opening and throughout the relationship, there is an opportunity to link a savings account or link a line of credit and then customers can move those funds back and forth and make sure that they have the appropriate coverage. So we do have all of those things. And so at those points of sale, money can literally move over and cover those particular transactions and people aren't denied of them. So we essentially have the same capability.

What I was essentially focusing on was if someone just simply didn't opt-into those programs, in the current environment, we simply wouldn't authorize the transaction if there weren't funds there.

Senator REED. Well—yes, sir, Mr. Livieri. Thank you.

Mr. LIVIERI. A lot of times, and it has been my policy, and it has been quite a while, but I remember having a credit card or a debit card or whatever and you put it in the machine and you say you want $200 or whatever it is, and then it says the fee will be $18. Do you want to continue? And if you say no, the transaction is null and void. That is OK. As long as you know what it is going to cost you, if you want it, you do it. If you don't want it, you just put "no" and forget about it.

Senator REED. And I think you are right.

Mr. LIVIERI. Doing it without you knowing what they are going to charge, that is a horse of a different garage.

Senator REED. I could not say it any better. I better remember that, a horse of a different garage.

Chairman DODD. A different garage. That is a new one for me, Mr. Livieri. And a garage of a different color.

[Laughter.]

Senator REED. Mr. Chairman, thank you.

Chairman DODD. Thank you very much, Senator Reed. Good questions.

Let me pick up on the points that Senator Reed was making. It may be duplicative. I hope it is not. But, you know, for many, many years, the Federal Reserve—because it is the Federal Reserve, Ms. Fox, you are correct, that actually has the primary responsibility or has had the primary responsibility in this area of consumer protection. And they have been aware of the abusive overdraft fees for a long time. In fact, an interagency guidance in 2005 called overdraft coverage programs "abusive and misleading." That is 4 years ago. That is their words to describe this going back in 2005.

Over the past several years, of course, the Federal Reserve has issued modest rule after modest rule to address the programs. And I am pleased to see what they have done. I do not want to have anyone leave the room here thinking we are not grateful, but I understand in a sense. I would love to be convinced that it would have happened in the absence of introducing legislation in this regard and also absence of the consideration of the financial regulatory reform proposals that are out there. And as I say, I have a lot of respect for Ben Bernanke, and I do not say that lightly. I think he has done a very good job, and I do welcome these changes here, it seems to me. But are these sufficient rule changes going to be adequate enough? And let me just take advantage of the panel here, and, again, I say this not because it should be punitive or adversarial, but merely sort of to complete the entire picture if we are looking at creating stability and safety and soundness in financial institution, which we all want. At the same time, it is very, very important that people like Mr. Livieri, a hard-working guy who ran his own business for 50 years, goes in and does a simple transaction and ends up paying $140 for a $2.17 overdraft, you know, again, if this were the bizarre exception, I would not have him here. He would not come here. Mistakes happen. Unfortunately, this happens with great regularity.

And the idea that in this reorganization of the regulatory process here, instead of me going through the process—and, look, all of you understand and know the Senate pretty well. The likelihood I can take a bill like this and get it out of Committee, get it on the floor of the U.S. Senate, go through a week or two, maybe, if I am lucky here, without a whole lot of other things being added to it, to complete it in the other body of 435 people, to have the President of the United States sign it into law, in order to get some changes that the Federal Reserve 4 years ago called abusive and misleading, it seems to me it cries out for a different process here that would allow an agency with responsibility of confirmation by the Senate, appointment by the President, to watch out for what happens to the Mr. Livieris of this world.

I should not have to go through this process on every matter like this. This ought to be delegated to a responsible regulatory body to provide the kind of protections.

In the Great Depression, we came up with the Federal Deposit Insurance Corporation. We did not require a piece of legislation every time a bank failed to make sure that the depositors in those banks were going to have their money protected. With the Securities and Exchange Commission, we guaranteed that if you bought a share of stock, you were not going to be deceived and defrauded.

Now, obviously, that still goes on, the Bernie Madoff case. But, nonetheless, there was an agency of protection rather than a bill in Congress every time some action occurred out there.

Shouldn't we today in the 21st century, given all the wonderful technologies that exist today that can inform consumers of what is going on—I apologize for the length of this question, but it just seems to me it cries out. This is a further example of instead of waiting around and hoping and praying, despite years of acknowledgment of this problem existing and waiting for a bill to get passed by Congress, we would have responsible people at a responsible regulatory body making these kinds of decisions. Doesn't it cry out for an independent consumer—if your lawn mower breaks today, you can call somebody and say, you know, "The warranties are not there. Who can help me out to get my money back from a faulty product that I got sold, a consumer product?" Who do you call when all of a sudden you are Mr. Livieri and you have been taken to the cleaners for 140 bucks for a $2.17 transaction? Who does he call? He called his Senator. You should not have to call your Senator.

Ms. FOX. Right. And if he calls the bank regulatory agency, they will tell him, "This did not violate any rule. This did not violate any law."

Chairman DODD. He was told that. It was legal.

Ms. FOX. They can charge you any amount. They can charge you any number of fees. They can charge you over and over for the same overdraft, that there are no limits on what the banks can do in this area. And you are correct that a Consumer Financial Protection Agency would be very important to keep this kind of abusive practice from getting out of hand.

Chairman DODD. Mr. Pollack, I do not mean to draw you into this, but, you know, you are in the business of financial services. Do you have a reaction to this? I do not even know what your answer would be, so I am just curious what your thoughts are.

Mr. POLLACK. Well, at PFCU we believe that the CFPA is a good idea. We think that the ability of an agency to focus solely on consumer protection will make that agency more effective. The fact of the matter is today that regulators have a very difficult job and have to cover a lot of ground, and I do not think that anybody at any of the regulatory agencies was trying to do a bad job. I do not think that at all. I simply think that when you are trying to cover a lot of ground, you cannot do as well as when you are focused on one sole area.

So we believe strongly that the CFPA is a beneficial event for the American consumer.

Chairman DODD. Yes. Mr. Carey, I will invite any comments you want to make. I will let you even speak as a private individual here rather than representing the bank.

Mr. CAREY. I think the best thing I could say is that clearly there is an opportunity to improve consumer protection, and whether it is through the CFPA or whether it is through enhancing the authorities, Senator, you probably know that better than I do. But, clearly, the stories that you are describing here deserve attention, and if it is not being done by the regulatory agencies, then the questions have to be asked as to why not.

Chairman DODD. Yes. And, of course, Mr. Calhoun, we know where you stand on this. You have already spoken about it. But do you want to make additional comments—Senator Merkley returned. I apologize. I did not see you walk in the room, Jeff, so why don't you just jump in here. I do not know much longer we will have before a vote starts. Go ahead.

Senator MERKLEY. Well, I wanted to ask a question, and I apologize that I had to leave and come back, so if this has been answered, you can just indicate to me to check the record, if you would. But I use a debit card, a Visa debit card, for just about everything that I am purchasing. And I try to keep enough balance to not worry about this issue of overdraft. But how difficult would it be to have a system in which I could be given a real-time choice of whether or not, if I have, in fact, depleted my funds with a transaction and I am buying a newspaper in the airport, how difficult would it be to give a real-time warning and allow me to choose do I wish to have an overdraft and pay a fee for that or simply not do the transaction?

Mr. CALHOUN. Why don't you start, John.

Mr. CAREY. Right now the technology is there, but it is not capable of being done now. In other words, it is not like we have to invent a new idea. We do not have to invent the transporter room in order to make this happen. The technologies are there. The processes are not. And that requires the cooperation of merchants, it requires the cooperation of banks, and it requires the cooperation of the networks to get that done.

So it is not there today, but, for example, it is your own ATM, and it should be for your—you are on us or your home ATM about having that capability, if you do this, you are going to be overdrawn, would you like to go forward with the fee? So it is not that far away, but there has to be the incentive to be able to basically go out and build it. And part of that is—and that is the point that I have been trying to make—until that is there, then perhaps the transaction should not be approved, just simply flat out not approved. So if there is a market for that, if there is the need for that, then let us build it and let us give consumers the choice at the moment in time they need it most.

Senator MERKLEY. And it does not seem that long ago that that was the response. You have hit your limit, ad your transaction will not go through.

Mr. CAREY. Right.

Senator MERKLEY. That is just a few years ago, isn't it?

Mr. CAREY. According to the testimony today, again, at Citi we do not do it, and so if you do not have the dough in the account or it is not linked to another account, there just simply are not funds available for you to draw, the transaction is not authorized. And I suspect that that was a much more typical practice earlier on, and it has migrated over time. But I am sure Mr. Calhoun has a point of view on this.

Mr. CALHOUN. I would echo his comments that it is not going to immediately be available to have point-of-sale real-time warning. And it is critical that reform not be dependent upon that, because particularly if you set the standard as universal two-way communication, there is going to be a gas station out in some small county that it may be 10 years before it would have two-way communication. And I think as this bill properly does, it ought to set the goal and the incentive to move in that direction. But in the absence of that warning, the practice should be and the law should be that no fee should be charged on those debit transactions.

If the bank for convenience or for a particular customer wants to cover it, this bill, 1799, does not prohibit it. It prohibits, though, these abusive fees, which also—I think a point that has not been covered—these fees actually beget more defaults. The majority of these fees are from accounts where people have fallen into a hole where they cannot make up the money, and most of these fees, programs, overdraft fees have, for example, $500 limits. Once you hit that limit, you are getting checks turned down even or overdrafts turned down. You have just been triggered into all these defaults, because, as we heard about, the defaults put you behind and a lot of people's paychecks cannot catch up that hole and cover their deficiency, so next month they are facing more of these overdrafts.

Senator MERKLEY. Well, and I would think that regardless of the technology for the two-way communication in the future, right now we have the old style that would work, which is a bank could say, "Well, Jeff Merkley, you have a choice. You can either sign up for a line of credit and have your overdraft covered by a line of credit. Or you can choose for us to turn down your transaction if you have hit your limit." Or you can choose to do some third option. But there are a range of options that could address this that we do have the technology for right now.

Mr. CALHOUN. Yes.

Senator MERKLEY. OK.

Mr. CAREY. That is correct. We do.

Senator MERKLEY. Thank you, Mr. Chair.

Chairman DODD. Well, it is a great line of questioning and an important point. I feel each of our colleagues raises certainly—it may have been you, Senator, and maybe some of you know the answer to this. As I heard it, it was something like 17 or 20 percent of consumers are paying about 90 percent of the fees. Am I close to accurate on that, something like that?

Mr. CALHOUN. Yes, Mr. Chairman.

Chairman DODD. It is a relatively small number of people, and they are people, obviously—I will not say "obviously," but primarily people who are in difficulty, lost their jobs, are in difficult straits, going through a medical crisis of one kind or another. They are in a tough spot. Is that correct? Do I have the numbers?

Ms. FOX. Yes, Senator, the FDIC did a very extensive study that was issued late last year, and they reported that 9 percent of customers had 10 or more overdrafts in a year. You know, 25 percent of banking account customers overdraw in a given year. So it is a very small fraction of customers who are keeping the banks afloat with $24 billion——

Chairman DODD. So it is that constituency that has paid the $24 billion last year and the estimated $38.5 billion this year.

Ms. FOX. Yes. I think the $38.5 billion includes both bounced check and overdraft fees.

Chairman DODD. Yes.

Ms. FOX. But that is the cost to consumers of not having sufficient money in the bank accounts and the banks going ahead and loaning money and charging a fee.

Chairman DODD. Well, here I have got it. Let me give it to you exactly from the FDIC.

Ms. FOX. Yes, that is great.

Chairman DODD. The FDIC reported that 93 percent of all overdraft fees are paid by 14 percent of account holders.

Ms. FOX. Yes, that is about right.

Chairman DODD. So 14 percent of account holders pay 93 percent of that number.

Ms. FOX. And a lot of those fees——

Chairman DODD. And so it is the worst off, people who are struggling the most, are paying the lion's share of these billions of dollars in fees. That is ridiculous.

Mr. CALHOUN. And, Mr. Chairman, if I could add, there are really sort of two subgroups, again, over—there are two separate problems. Over 27 million families that will pay five or more overdrafts in this year based on the last data, so that is a pretty good hit. And then there is this group that just gets hammered because that same study found that the average household in that high-use group paid $1,600 a year in overdraft fees—$1,600. So you really have—but the abuse is not just that very high use. It does spread across a much larger swatch of account holders—27 million, to be exact.

Mr. CAREY. Senator, if I may.

Chairman DODD. Yes, Mr. Carey.

Mr. CAREY. A couple points worth making. What I asked, because I anticipated this question, is that I wanted to see whether there was a disproportionate impact of the people who receive an overdraft fee or an NSF fee across our checking account business. Again, since we do not do the debit and we do not do the ATM, so this is limited really to a group that would otherwise be bouncing checks. And it actually does not spread out to—it does not load up on the LMI. It spreads out across the entire spectrum.

So, again, I want to make sure that we are focusing on the problem, and the problem to me is around the velocity of electronic debit and ATM transactions where people are just simply caught unaware.

Chairman DODD. And we again appreciate what Citi has done in this area.

Mr. CAREY. Thank you.

Chairman DODD. Have I said that enough times?

Mr. CAREY. You have, and I appreciate it very much. You can never say it enough.

[Laughter.]

Chairman DODD. We appreciate the step in the right direction. Well, that is an interesting statistic as well. Tell me again how that works. Among your check cashers——

Mr. CAREY. In essence, because it is primarily made up of people who are writing checks or are overdrawn through ACH transactions, and the question that I ask is: You know, it is disproportionately impacting LMI? And it is not. It is spread out across that spectrum. And I think the reason why is because we do not charge that fee, people are not caught with—they are not using debit cards the way——

Chairman DODD. I suspect another factor is that an awful lot of low-income people do not have checking accounts. There are 10 million people in this country that never access a traditional financial institution other than through credit cards and debit cards the way they do things. So there is that element, Yes, Ms. Fox?

Ms. FOX. Senator, a few years ago Congress enacted EFT 99 to require that Federal benefit recipients get direct deposit of their income—Social Security, SSI, veterans benefits. So we have pushed a lot of unbanked consumers into mainstream banking without making it safe for them to have bank accounts. And all the Social Security and SSI are supposed to be exempt from attachment. Banks take that money to pay overdraft fees for overdrafts they permitted to take place. So that is a drain on older consumers and low-income consumers.

The FDIC study looked at a cross-section of large and small banks that they supervise. They do not have the big money center, big national banks in their field of supervision. But if you look at banking across the board, it is low- to moderate-income consumers who have a bank account; they do not have enough money to make ends meet, and the banks are not helping them avoid fees.

Chairman DODD. And they have problems. Thank you.

One of the things I wanted to point out, I think the idea of letting someone know they could opt-into an overdraft coverage, but we need to make sure that, one, these fees are not going to be excessive, which is a point we made earlier, and also that there are alternatives such as lines of credit or linked accounts that, again, Citi does but not everyone else does—in fact, they have moved away from that—are important as well, but consumer awareness about what is available to them, rather than just do you want to have a fee charged or not have a fee charges, but what else is available to me, ought to be critically important.

Senator Merkley.

Senator MERKLEY. Thank you.

Mr. Carey, I wanted to ask you about the type of conversation your financial institution went through, because I picture a board meeting in which someone comes forward and says, "Now, our competitors are charging these fees for overdrafts, and it is X billion dollars a year, and to be competitive, we want to make sure we do not give up this source of revenue." And someone Citibank came to the conclusion not to do that, and I am just—could you walk us through the thinking that transpired?

Mr. CAREY. Well, I am not sure if you were here earlier, but what I said is we just simply——

Senator MERKLEY. No, I missed it. I apologize.

Mr. CAREY. We have just never done it, and it has not been part of the sort of fabric of the company in this space. You know, people are very unhappy about fees in general, and I think you have to basically try and drive better transparency. You know, I am responsible for business practices within the consumer businesses, and a lot of it is centered around all sorts of revenue opportunities. And we spend a great deal of time in those discussions trying to weigh all of the risks and rewards that come from that, such as the damage to reputation risk, what is the potential revenue opportunity, where are we in the competitive space. And there is vigorous debate and discussion, and it is a very good and, I think, useful process that we do to try and come up with really what the right answer is. But it is through those kinds of things that we come up with the decisions that we do come up with about what makes the most sense. And I think what we would like to believe is that, you know, at the end we have got to be entirely transparent to our customers. We have got to make sure that they understand exactly what is going on and that they have informed choices and that they can make those choices over a reasonable period, you know, in a reasonable time so that they are not trapped, and that that is basically a bedrock in how we look at these things.

Senator MERKLEY. Thank you.

Mr. CALHOUN. Senator, if I may add, I think Citi's testimony addresses an important point that was raised earlier today. There was concern that perhaps this reform effort would disadvantage other consumers, and particularly one argument that has been thrown out is somehow that if you regulate overdraft fees, it would mean the end of free checking, which lots of consumers like. And I think two points are: first of all, Citi finds a way to both turn down and not charge overdraft fees on debit cards but still offer free checking; and free checking predated these aggressive, abusive overdraft programs. They are not interdependent, and that if you take away the abusive overdraft, you are no longer going to have free checking.

Chairman DODD. No, and that is a good point, and you have provoked me to say, as someone who obviously negotiated and tried for many, many years to get some reform of the credit card industry and this year, thanks to Senator Merkley and other Members of this Committee, we were able to get out of the Committee by a one-vote margin the credit card bill, and yet it passed the Senate overwhelmingly, but one of the reasons we negotiated that process was a delay before implementing the provisions of that bill in order to provide at the request of the industry time for them to be able to adjust to the changes. What, of course, they have done in that interim period is not just adjust to the changes, but charge outrageous fees, and interest has just been skyrocketing in this window, to get as much out of this window as you could get, completely defying, in effect, the very request they made, and that was to basically allow for an adjustment period, which I thought was a reasonable request. I am angry now in a sense that they took advantage of that request in here, and we, of course, got legislation to put a freeze on here if we can get it done. I do not know if we can or not. And they have been arguing then, "You see, this is what happens, because you have changed the rules now, we are going to end up doing all of these things, and we are only doing them because you passed the credit card bill." And, frankly, that is baloney, that argument, and, frankly, the argument now that we are going to do away with free checking and other things. Citi is a living example of what you can do. You can do exactly what they have done with the debit and the credit cards, also provide free checking, and have a very reasonable response in these areas. So I hope that those who are involved in the lending institutions are not going to try these tricks, again, further evidencing why you need a Consumer Financial Product Safety Agency. You do not have to have a bill in every time. Here I have got to introduce a bill again to put a freeze on these rates instead of having an agency that could put an end to it immediately without having to go through all of this.

Well, I thank all of you. You have been very gracious. Mr. Livieri, we thank you particularly. You have come down, and we know it is not easy for anyone to stand up and talk about something. And, again, I think all of us agree. I think we all bear responsibility at the outset to conduct our affairs and be knowledgeable about where we are in these matters. And so to stand up and to talk about a situation that involved $2.17 for a guy who has been in business for many, many years obviously is an uncomfortable moment, but we appreciate your doing it because you become the face of an awful lot of people. These are not just numbers and statistics, so we are very grateful to you.

Mr. LIVIERI. Thank you for the opportunity.

Chairman DODD. I appreciate it. Again, Ms. Fox, Mr. Pollack, Mr. Carey, Mr. Calhoun, we thank you as well.

The Committee will leave the record open for additional questions that Members may have, but, again, I am pleased that all of you were here. The Committee will stand adjourned.

[Whereupon, at 4:37 p.m., the hearing was adjourned.]

[Prepared statements supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Thank you all for being here this afternoon.

Our job on the Banking Committee is to make sure that regular folks get a fair deal from their banks.

For too long, credit card companies made profits by charging consumers outrageous fees, or raising rates whenever they felt like it.

Our Committee approved legislation to stop those abusive practices, legislation that passed the Senate with overwhelming bipartisan support and was signed into law by President Obama earlier this year.

Today, we meet to discuss another abusive practice—misleading overdraft programs that encourage consumers to overdraw their accounts then slam them with a high fee.

Now, let's be clear. People have a responsibility to spend within their means. And banks have a right to charge a fair fee for legitimate services.

But banks often add overdraft coverage to consumer accounts without informing them or giving them a choice.

The overdraft charge is usually a high fee—a consumer can pay a $35 fee for overdrawing on a $2 transaction.

In some cases, a consumer can rack up multiple overdraft fees in a single day without being notified until days later. Many institutions also charge additional fees for each day an account is overdrawn—the longer it takes for you to realize there's a problem, the more fees they can charge you.

Sometimes, banks will even rearrange the order in which they process your purchases, charging you for a later, larger purchase first so that they can charge you repeated overdraft fees for earlier, smaller purchases.

So the truth is that the "service" of overdraft protection often serves as nothing more than a way for banks to profit by taking advantage of customers.

Last year, American consumers paid $24 billion in overdraft fees, and the *Financial Times* recently reported that banks stand to collect a record $38.5 billion in overdraft fees this year.

According to the Center for Responsible Lending, nearly $1 billion of those fees will come from young adults. Another $4.5 billion will come from senior citizens like Mario Livieri, one of our witnesses today and a resident of Branford, Connecticut.

I'll let Mario tell his own story about how an initial $2 overdraft ended up in $140 in overdraft coverage fees. The methods his bank used will sound familiar to many Americans.

Families in my State of Connecticut and across the country are already struggling to make ends meet—and these unfair and excessive charges are making it even harder.

Last week, the Federal Reserve announced that they will require banks to get a customer's consent before enrolling them in an overdraft coverage program. It was a welcome but long-overdue announcement for American consumers.

And, we need to do far more to protect them from these abusive bank products.

That's why I introduced—The Fairness and Accountability in Receiving Overdraft Coverage Act. Senators Schumer, Reed, Brown, Merkley, Menendez, Levin, Reid, and Franken have joined me as cosponsors.

Like the Federal Reserve's rule, my bill would establish an opt-in rule for overdraft coverage for ATM and debit transactions. Customers would now have to consent before overdraft coverage is applied to their account.

My legislation would go further and limit the number of overdraft fees banks can charge to one per month, and no more than six per year. And that fee would have to be reasonable and proportional to the cost of processing the overdraft.

My legislation would also put a stop to the practice of manipulating the order in which transactions are posted, and require banks to warn customers if they are about to overdraw their account, giving them a chance to cancel the transaction.

Finally, it would require banks to notify customers promptly when they've overdrawn an account—through whatever means the customer chooses, from e-mail to text message—so that they can quickly restore their balances and avoid unnecessary fees.

Abusive overdraft policies are blatantly unfair. And the banks know it. After it came out in the press that I was working on this legislation, a few of the big ones took steps towards responsible reform—I assume out of the kindness of their hearts.

We will see whether they are truly committed to reform. But folks like Mario deserve better.

Last week, the Federal Reserve released a new rule that will require banks to get a customer's consent before enrolling them in an overdraft coverage program. That's a good start. But my legislation goes further, and I remain committed to ensuring that American consumers are protected.

And let's remember, regulators did little while consumers were taken advantage of by these misleading and unfair overdraft programs. This is exactly why we need an independent consumer financial protection agency that would be focused on preventing these abuses and addressing them quickly.

Folks like Mario deserve better. I remain committed to ensuring that American consumers are protected—and I look forward to our discussion today.

PREPARED STATEMENT OF SENATOR JIM BUNNING

We now live in a time where no one is responsible for his or her own actions. We have witnessed billion dollar bailouts of irresponsible banks, and automakers who operated on flawed business models. We have also witnessed people who used their homes as a line of credit and took on too much debt receive a bailout from those who acted responsibly. The Federal Government continuously rewards irresponsibility at the expense of responsibility. So why should Americans be responsible for overdrawing funds from their checking accounts? While I understand the significant impact unreasonable fees can have on consumers, I also recognize that it is the responsibility of individuals to have a better knowledge of their own financial situation.

Again, the Federal Reserve has dragged its feet in implementing consumer protections. We saw this with mortgage regulation and now with overdraft fees. While the Fed is late in doing so, I believe their recent rules outline some key issues in this debate.

It used to be considered "illegal" to overdraw from your checking account. In today's technological age, consumers have many different methods of confirming their checking account balance and there is no excuse for not knowing how much money is in their individual accounts. If a person wants overdraft protection on his or her checking account and agrees to pay a fee in the case of an overdraft, that person should have the option to do so if his or her bank wants to offer that service. On the other hand, if a person realizes that he or she could possibly act irresponsibly and would rather pass on overdraft protection in exchange of having his or her debit card rejected at the time of purchase, then that person should have the ability to make that decision. Capitalism thrives on choice and it only makes sense to give consumers a choice on what kind of financial product caters to their financial needs. But with that choice comes responsibility and consumers must be expected to face the consequences of their actions. I look forward to debating this important issue.

PREPARED STATEMENT OF MARIO LIVIERI

CONSUMER, STATE OF CONNECTICUT

NOVEMBER 17, 2009

Good afternoon Senator Dodd and esteemed Members of the Committee.

My name is Mario Livieri. I am a senior citizen, and I live in Branford, Connecticut. I'm honor to be invited here today to share my story with you. I hope that it will help you do right by consumers like me, who have been treated unfairly and misled by their bank about overdraft fees.

Until a few months ago, I was a customer at a prominent bank in my town. I am no longer a customer there, because I don't think they treated me fairly.

Over the summer, I wrote a check for $200. When the check was cashed, it overdrew my checking account by $2.17. My bank charged me a $35 fee for my $2.17 mistake.

I had no idea I'd overdrawn my account. If I had known, I would have immediately deposited money in the account to cover the overdraft.

But instead, it took the bank over a week to notify me of the overdraft. By the time they finally got around to telling me my account was overdrawn, I had made a few other small purchases using my debit card totaling about $100—and the bank charged me $140 in fees.

Now, I owned a small business—a building and lumber company—for 50 years. And I know that it's important to stick to a budget. But I also know that you don't get anywhere in the world of business by treating your customers unfairly.

So, I called the bank. After a whole bunch of arguing, they agreed to refund one $35 charge, but insisted that I pay all of the other fees. I told them I didn't think that was fair. They told me it was legal.

I've been in business too long for that to be an acceptable answer. If that sort of practice—running up ridiculous charges for an overdraft "protection" program I didn't even sign up for—is legal, it shouldn't be. And it certainly isn't fair.

I'm glad my Senator, Chris Dodd, is doing something about it. And I'm grateful to the entire Committee for the opportunity to discuss my story with you today. There are a lot of folks like me in your States who are in the exact same situation—they made a little mistake and got slammed for it by their bank.

I hope that we can stop abusive overdraft coverage practices so that nobody else, no matter what bank they use, has to go through what I went through.

Thank you for inviting me here today and thank you for fighting the good fight on behalf of us consumers.

PREPARED STATEMENT OF JEAN ANN FOX

DIRECTOR OF FINANCIAL SERVICES, CONSUMER FEDERATION OF AMERICA

NOVEMBER 17, 2009

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, I appreciate the opportunity to testify in support of the FAIR Overdraft Coverage Act, S. 1799, on behalf of the Consumer Federation of America,[1] as well as Consumer Action,[2] Consumers Union,[3] USPIRG,[4] National Association of Consumer Advocates,[5] and the National Consumer Law Center (on behalf of its low income clients).[6] We also commend Chairman Dodd for the financial reform discussion draft he released last week, and in particular, his proposal for the creation of a Consumer Financial Protection Agency. This agency would not only implement the FAIR Overdraft Coverage Act, but also enforce the law and clamp down on other high cost loan abuses. The agency will monitor the marketplace both for evasions in current law and watch out for new products and services designed to trip and trap consumers.

We appreciate your interest in protecting consumers from unauthorized and extremely expensive overdraft loans, the banking equivalent of payday lending. Marketed as "overdraft protection" or "courtesy overdraft," fee-based overdraft programs protect the banks' ability to maximize fees while jeopardizing the financial stability of many of its customers. Rather than competing by offering lower cost and truly beneficial overdraft products and services, many financial institutions are hiding behind a smokescreen of misleading terms and opaque practices that promote costly overdrafts.

Without asking for their consent, banks and credit unions unilaterally permit most customers to borrow money from the bank by writing a check, withdrawing funds at an ATM, using a debit card at the point of sale, or preauthorizing an electronic payment that exceeds the funds available in a checking account. Instead of rejecting the debit card purchase or ATM withdrawal at no cost to the consumer, or returning the check unpaid with a bounced check fee, most institutions will now cover the overdraft and impose an expensive fee for each transaction.

Consumers do not apply for this form of credit, do not receive information on the cost to borrow bank funds via overdrafts, are not warned when a transaction is

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[1] The Consumer Federation of America is a nonprofit association of over 280 pro-consumer groups, founded in 1968 to advance consumers' interest through advocacy and education.

[2] Consumer Action (*www.consumer-action.org*) is a national nonprofit education and advocacy organization serving more than 9,000 community based organizations with training, educational modules, and multilingual consumer publications since 1971. Consumer Action's advocacy work centers on credit, banking, and housing issues.

[3] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health and person finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers.

[4] The U.S. Public Interest Research Group (USPIRG) serves as the federation of and Federal advocacy office for the State PIRGs, which are nonprofit, nonpartisan public interest advocacy groups that take on powerful interests on behalf of their members.

[5] The National Association of Consumer Advocates, Inc. is a nonprofit 501(c) (3) organization founded in 1994. NACA's mission is to provide legal assistance and education to victims of consumer abuse. NACA, through educational programs and outreach initiatives protects consumers, particularly low income consumers, from fraudulent, abusive and predatory business practices. NACA also trains and mentors a national network of over 1,400 attorneys in representing consumers' rights.

[6] The National Consumer Law Center, Inc. (NCLC) is a nonprofit corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, Government, and private attorneys representing low-income consumers across the country.

about to initiate an overdraft, and are not given the choice of whether to borrow the funds at an exorbitant price or simply cancel the transaction. Banks are permitted by the Federal Reserve to make cash advances through overdraft loans without complying with Truth in Lending cost disclosure rules, denying consumers the ability to make informed decisions about whether to access credit, as well as comparison shop for the lowest cost overdraft program.

Overdraft loans are the bank equivalent of payday lending. Just as payday lenders use the borrower's personal check or debit authorization to insure priority payment, banks use their contractual right of set-off to collect the amount of the overdraft loan and the fee by taking money out of the next deposit into the borrower's checking account, even when the funds are Social Security or other exempt funds. Overdrafts are typically repaid within days, and the flat overdraft fees for very short-term extensions of credit result in outrageous interest rates.

Common banking practices, as confirmed by the FDIC's 2008 study of overdraft programs, now increase the number of overdrafts rather than minimize them—and can cost the account holder hundreds of dollars in a matter of hours, when they otherwise may have been overdrawn by just a few dollars for a few days or less.

Debit card overdrafts are now the single largest source of overdraft fees and are especially costly for account holders because they carry the same high flat fee but for much smaller loans. As recently as 2004, about 80 percent of banks rejected unfunded debit transactions without charging a fee. As consumers have switched to payment by debit instead of paper checks, banks have expanded overdraft programs that cover debits to make up for disappearing bounced check fees.

Abusive overdraft loans are costly for everyone, but are most destructive to people who are struggling to meet their financial obligations. The FDIC's study found that consumers most likely to be charged repeated overdraft fees are younger consumers and lower-income consumers. In a system hugely out of balance, our big financial institutions are collecting enormous fees from people who have nothing to spare, making them even less able to meet their obligations.

Banks continue to increase the dollar amount of fees, even as the recession makes consumers less able to pay ever higher fees for inadvertently overdrawing their accounts. Banks that received TARP funds from the public have not returned the favor. Indeed, the most recent CFA survey of the Nation's 16 largest banks found that overdraft fees continue their upward spiral, with the largest fee charged by big banks ranging from $34 at Citibank (up from $30 in the last year) to a maximum $39 charged by Citizens Bank. The median maximum overdraft fee for the largest banks is now $35. While major banks have announced changes to their overdraft programs in recent weeks, none of the largest banks have lowered the price for an overdraft.

We strongly support S. 1799 as a strong solution to the problem of overdraft lending. This legislation will help stop the abuse, without limiting the ability of financial institutions to provide genuine protection for their customers. While the Federal Reserve Board's new rule under the Electronic Fund Transfer Act is a good first step, the comprehensive protections in this legislation are essential to protecting consumers and making it safer for consumers of modest means to use mainstream banking.

In this testimony:

- We will describe the dysfunctional overdraft lending system that now dominates the market, the failure of bank regulatory agencies to protect consumers, and the vulnerable consumers most likely to use overdrafts. Our testimony also documents that consumers want to opt-in and have warning before triggering debit overdrafts and oppose manipulation of payment processing that drives up total fees.
- We will explain that abusive overdraft lending costs $24 billion per year and that nearly half of these fees come from overdrafts triggered by debit cards at the checkout counter or ATMs—overdrafts that could be prevented with a warning or if the transaction were simply declined. We will review overdraft fees and practices at the Nation's largest banks, including recently announced voluntary "reforms."
- We will recommend that Congress enact S. 1799, a solution that will put real protection back into overdraft policy, and enact the Consumer Financial Protection Agency to enforce this law.

Abusive Overdraft Lending Systematically Strips Funds From Checking Accounts

Fee-based overdraft loans should not be confused with cheaper sources of backup funds for checking accounts. Under traditional programs that link checking accounts to a savings account or line of credit, which are legitimate money management tools, funds are transferred in increments when the checking account is temporarily overdrawn. Financial institutions have offered such programs for decades. The largest banks charge a median $10 fee to transfer consumers' funds from savings accounts to cover overdrafts in their checking accounts. Banks with overdraft lines of credit generally charge around 18 percent per year and provide installment repayment arrangements.

Today, banks commonly automatically enroll their checking account holders in a high-cost fee-based system at the time they open a checking account or add this feature for existing customers without their consent. The FDIC reports that over three-fourths of the banks it surveyed automatically pay overdrafts for a fee and seventy-five percent of those banks automatically enroll their customers in overdraft programs without their permission.[7] If an account dips into a negative balance, the bank routinely covers the overdraft—a change from past practices—paying the shortfall with a loan from the banks' funds. When the account holder makes the next deposit, the bank debits the account in the amount of the loan plus a fee, which now averages $34.[8] At the largest banks, the median overdraft fee is $35.

Overdraft Loans Give Banks First Claim on Consumers' Pay or Benefits

The method in which overdraft loans are collected contributes to the harm they cause consumers. Banks, with the Federal Reserve's permission, currently treat overdraft loan "fees" as checking account fees under the Truth in Savings Act. As a result, banks can and do use set-off to pay themselves first out of the consumer's next deposit of pay or benefits. Consumers caught by overdraft loans do not get affordable installment repayment schedules. The full amount of the overdraft and the fees are due and payable immediately and the bank reserves the right to deduct full payment out of the next deposit of funds into the account, giving banks the first claim on a consumers' income.

For low-income account holders who have no cushion of cash in their bank account, repayment of the overdraft and the average $34 charge is difficult to make up before another debit hits their account, sending them further into the red, triggering another $34 fee, and accelerating a downward spiral of debt. As discussed below, a small percentage of customers end up paying enormous amounts for overdraft loans, and these consumers tend to be lower-income and minorities.

Consumers Trapped in Overdraft Loans Can Least Afford Astronomical Fees

Overdraft loans create a debt trap for a significant number of consumers. The FDIC examined individual transaction information from 39 banks to provide a snapshot of customers who overdrew their accounts on 22.5 million transactions. Nine percent of customers had 10 or more insufficient fund transactions in 1 year. Consumers who overdrew 10 to 19 times in 1 year paid $451 in fees, while consumers who overdrew 20 times or more paid $1,610 in fees per year.[9]

Unfortunately, abusive overdraft fees have the greatest impact on those who can least afford them. In July of this year, 13 percent of a representative sample of 2000 adult Americans surveyed for CFA by Opinion Research Corporation said they had taken out a bank overdraft loan to cover a check or debit purchase or ATM withdrawal in the past year. Eighteen percent of those with incomes under $25,000 said they had used such a loan while 26 percent of African-Americans paid for overdrafts in the last year.[10] Two Center for Responsible Lending (CRL) surveys, conducted in 2006 and 2008, found that account holders who are repeatedly charged abusive overdraft loan fees were more likely to be lower income, single, and nonwhite.[11] The

[7] The FDIC Study found that 75 percent of banks surveyed automatically enrolled customers in automated overdraft programs. FDIC Study of Bank Overdraft Programs at iii (Nov. 2008) [hereinafter "FDIC Study"].

[8] 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 8 (Jan. 25, 2007), available at *http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf* [hereinafter Debit Card Danger]. The FDIC study found that the median fee charged by surveyed institutions was $27. CRL's 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. 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 at 16 (Jan. 2008) (noting larger institutions' average NSF and overdraft fees were higher than smaller institutions').

[9] FDIC Study. *Id.*

[10] ORCI Poll for CFA, July 2009.

[11] CRL Research Brief.

FDIC study also found that customers living in low-income areas carry the brunt of overdraft fees.[12] This is not a recent development. CFA conducted a national opinion poll in 2004 which found that 28 percent of consumers say they overdrew their accounts which would trigger either insufficient funds or overdraft fees. Consumers who stated they overdrew their accounts and were most likely to pay overdraft and bounced check fees were moderate-income consumers with household incomes of $25,000 to $50,000 (37 percent). Those 25 to 44 years of age (36 percent) and African Americans (45 percent) were most likely to have bounced checks.[13]

Overdraft fees strip funds from Americans of all ages, but research indicates they hit America's oldest and youngest checking account holders—often the least financially stable—especially hard. Older Americans aged 55 and over paid $4.5 billion of the $17.5 billion total overdraft fees paid annually in 2006,[14] an especially alarming figure given that one in four retirees has no savings of any kind.[15] Those heavily dependent on Social Security pay nearly $1 billion,[16] while those entirely dependent on Social Security pay over $500 million.[17]

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.[18] CFA's 2009 ORCI poll found that 17 percent of those 18–34 years old had used overdraft loans in the last year, compared to 13 percent for the total sample. Because younger consumers are far more likely to use a debit card for small transactions than older adults,[19] they pay $3 in fees for every $1 borrowed for debit card overdrafts.[20] 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.[21]

Banks Turn Debit Cards Into High Cost "Credit Cards" When Overdrafts Are Permitted

Today, banks swipe a large portion of these fees when their account holders swipe debit cards at ATMs and checkout counters. A 2007 CRL report found, and the FDIC study confirmed, that debit card purchases are the most common trigger of overdraft fees.[22]

When debit cards first came into common use, they promised the convenience of a credit card without the cost, because debit card users were required to have the funds in their account to cover their purchase or withdraw cash. As recently as 2004, 80 percent of banks still declined ATM and debit card transactions without charging a fee when account holders did not have sufficient funds in their account.[23] But banks now routinely authorize payments or cash withdrawals when

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[12] FDIC Study at v. It further found that account holders who overdrew their accounts more than 4 times per year paid 93.4 percent of all overdraft fees. *Id.*

[13] ORCI Poll for Consumer Federation of America, 2004.

[14] *See,* Shredded Security.

[15] *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).

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

[17] *Id.*

[18] *See,* 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) [hereinafter Billion Dollar Deal], available at *http://www.responsiblelending.org/pdfs/billion-dollar-deal.pdf.*

[19] 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 Mar. 15, 2009)).

[20] Billion Dollar Deal.

[21] *Id.* at 7 (citing "U.S. Bank Pays Campus for Access to Students", *Milwaukee Journal Sentinel,* June 18, 2007 (noting the agreement between U.S. Bank and the University of Wisconsin at Oshkosh prohibits all financial institutions other than U.S. Bank and the college's own credit union from locating ATMs on campus); Amy Milshtein, "In the Cards, College Planning and Management" (Dec. 2005) (noting the fee-sharing deal Higher One has with partner universities)).

[22] "Debit Card Danger." *See,* also, "FDIC Study of Bank Overdraft Programs" (Nov. 2008) (finding 41 percent of NSF-related transactions were triggered by point-of-sale/debit and another 7.8 percent by ATM transactions).

[23] Mark Fusaro, "Are 'Bounced Check Loans' Really Loans?", n. 4, at 6 (Feb. 2007), available at *http://personal.ecu.edu/fusarom/fusarobpintentional.pdf* (last visited Mar. 15, 2009). *See,* also Sujit Chakravorti and Timothy McHugh, "Why Do We Use So Many Checks?" *Economic*

customers do not have enough money in their account to cover the transaction, so debit cards end up being very costly for many account holders. Among large banks, Citibank stands out for not permitting debit card transactions to overdraw its customers' bank accounts, protecting those consumers from unexpected high fees.

Banks and credit unions could prevent every dollar of debit card overdraft fee charges by simply notifying account holders when they are about to overdraw their accounts or by declining a transaction when there are insufficient funds available, as they did in the past. Indeed, consumers would appreciate the warning: 80 percent of consumers surveyed would rather have their debit transaction denied than covered for a fee, whether that transaction is $5 or $40. [24]

Institutions often claim that denial at the point of sale or ATM is not feasible, but it would be surprising if banks couldn't accomplish now technologically what they could in 2004. Furthermore, 7.9 percent of banks in the FDIC survey reported that they did inform customers at a debit card point of sale that funds were insufficient before transactions were completed, offering the customers an opportunity to cancel and avoid a fee, and 23.5 percent did the same at ATMs. It's difficult to believe that these banks have some sort of advanced technology unavailable to other banks.

Absent meaningful regulatory reform, banks will only increase their profits from overdraft fees as debit card transactions continue to skyrocket. [25] 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.

Consumers Cannot Rely on Bank Overdraft Programs

Based on CFA's review of the largest banks' account disclosures and fine print in mid-2008, it is clear that consumers are unable to rely on their bank to honor overdrafts, are held responsible for immediately repaying the bank in many cases without notice or demand from the bank, and can have their overdraft "service" terminated at any time for any reason. Banks employ contract language making overdraft coverage a discretionary program. As a result, a consumer writing a check or paying by debit card never knows for sure whether the bank will honor or reject the overdraft. The consumer has no way of knowing whether any particular transaction will trigger merchant NSF fees, penalties for nonpayment, or legal problems from writing an unfunded check. [26] Banks set internal but unannounced limits on the amount consumers can overdraw an account. Even if a bank provides fee-based overdraft programs, an individual consumer initiating a transaction for more funds than are on deposit cannot know with certainty that the transaction will be covered by the bank.

Banks make no promise to pay an overdraft while obligating consumers to immediately repay both the overdraft and the fee in a single balloon payment (often without notice or demand). The new Federal Reserve Reg E rules maintain the discretionary nature of overdraft coverage, even when consumers opt-in to have debit card overdrafts paid for a fee. The Model disclosure form includes this statement: "We pay overdrafts at our discretion, which means we do not guarantee that we will always authorize and pay any type of transaction." [27] Banks use set-off to extract pay-

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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.")).

[24] 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].

[25] 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 Mar. 15, 2009).

[26] The Indiana Department of Financial Institutions warned banks that "courtesy" overdraft programs arguably entice consumers to unwittingly commit a criminal offense. "Since the Program gives no assurance of coverage in the event of an overdraft, but leaves that to the discretion of the bank, a customer will never be certain that a bad check will be covered. This could make both the customer and the bank accountable under the criminal statute." Letter from J. Philip Goddard, Indiana Department of Financial Institutions, February 21, 2002.

[27] Federal Reserve Board, Model Consent Form for Overdraft Services (205.17), Regulation E: Docket No. R-1343, Final Rule, November 12, 2009.

ment out of the next deposited funds, even when those funds are exempt Federal benefits.[28]

Banks Speed Withdrawals but Not Deposits

In this age of fast-paced banking and electronic bill pay, anyone can temporarily slip into a negative balance. Check 21, passed in 2004, allows banks to debit accounts more quickly, while the rules for how long they can hold deposits before crediting accounts have not been updated in 20 years. In an age of 24/7 online banking and branches open six and seven days a week, the expedited funds rules defining a "business" day to exclude weekends result in consumers overdrawing when deposits could have covered the transactions. When banks hold deposited local checks until the permitted second business day, a paycheck drawn on a local bank and deposited on Friday afternoon can be held until Tuesday before money is available in the account to cover transactions. Fifth-day availability for deposited nonlocal checks means consumers may have to wait a whole week for deposits to become available, even when the check is drawn on the bank where it is deposited.

Banks Manipulate the Order of Processing Withdrawals and Drive Up Fee Revenue

Financial institutions can manipulate the order in which withdrawals are posted in order to trigger more overdraft fees. Large institutions usually clear the largest transaction first, causing more transactions to overdraw the account. This practice generates more in overdraft revenues because the institution can charge an overdraft fee for each transaction once the account is below zero.

Consumers do not know the order in which items drawn on their account will be presented to their bank and are not likely to know the order in which their bank pays items. Banks bury the disclosures about the order in which they process transactions, and these disclosures provide the banks the widest possible latitude to engage in this behavior.[29] Even the Federal Reserve noted in adopting Truth in Savings regulations in 2005 that consumers who are aware that their account may be overdrawn are not likely to know the number of items that will bounce or the total fees they will be charged.[30]

Banks 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 when a bank has an overdraft loan program, because the bank pays all of the transactions, regardless of the order in which they are posted. So no matter what order the transactions are cleared in, all items get paid up to the bank's internal guidelines, and the only difference is how much the customer pays in overdraft fees. Legislation is necessary because bank regulatory agencies have failed to require banks to fairly treat their customers. (For a review of bank regulatory actions on processing order, please see Appendix C.)

Indeed, the FDIC's 2008 overdraft study found that over half of the large banks they surveyed process overdrafts from largest to smallest.[31] The survey further found, not surprisingly, that banks that engage in this abusive practice generate more overdraft fees than those that don't, but they also end up with more uncollectible debt related to overdraft loans.[32]

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[28] For examples of one-sided bank account contract terms, *See,* "CFA Comments to Federal Reserve Board", FRB Docket No. R-1314, August 4, 2008.

[29] *See, e.g.,* U.S. 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 Mar. 15, 2009): "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/efulfillmentODAO/new_window_np.cfm?appURL=https://www1.bankofamerica.com/efulfillment/&showdaddoc=91-11-2000ED&daddoc2use=20081101&type=1&view=htm* (last visited Mar. 15, 2009): "We may process and post items in any order we choose . . . We may change categories and orders within categories at any time without notice . . . [S]ome posting orders may result in more insufficient funds items and more fees than other orders. We may choose our processing and posting orders regardless of whether additional fees may result." 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 Mar. 15, 2009): "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."

[30] Federal Reserve Board, Final Rule, Regulation DD, Docket No. R-1197, 5-19-2005, p. 4.

[31] FDIC Study at iii (noting that 53.7 percent of large banks batched processed transactions by size, in order from largest to smallest).

[32] FDIC Study at 62.

CFA's review of the largest banks' account agreements and customer information for comments filed in 2008 at the Federal Reserve found that 15 banks disclose that they pay the largest transactions first or reserve the right to pay withdrawals in the order the bank chooses. There was insufficient information to determine payment order at one bank surveyed. Bank customer agreements typically reserve the bank's right to change the order of processing withdrawals without notice or consent from account holders.

The public wants banks to pay checks in the order they are received, as opposed to the current practice of allowing banks to routinely pay the largest first, which drains some accounts more quickly and increases bounced check fees. In a poll of 1,018 people conducted by Caravan Opinion Research Corporation for CFA this summer, 70 percent supported (53 percent strongly supported) this requirement.[33] This confirms the finding of an older poll conducted for CFA which found that only 13 percent of the public support the bankers' claim that consumers want the largest transaction paid first.

Consumers Want To Decide Whether To Use Fee-Based Overdrafts

Most banks do not require customers to apply for and affirmatively choose to use fee-based overdraft coverage. Using either consultant-provided overdraft programs or internal bank policies, financial institutions decide which customers will be permitted to overdraw, the limit on the amount of overdrafts, and the fee or fees that will be charged. Banks do not contract or promise to cover overdrafts but claim this is a discretionary service that can be withdrawn at any time.

Consumers Want Choice and Warning on Overdrafts

Consumers think they should be provided the opportunity to affirmatively opt-in to overdraft provisions of their checking accounts. CFA polled a representative sample of adult Americans in July 2009 and learned that 71 percent support requiring banks to gain the permission of customers before routinely providing loans to cover overdrafts. In CFA's 2004 ORCI poll, more than twice as many consumers thought it would be unfair for banks to permit overdrafts without obtaining their customers' consent (68 percent) rather than fair (29 percent).

The *Consumer Reports* National Research Center 2009 poll of a nationally representative sample of 679 people found that two-thirds of consumers prefer to expressly authorize overdraft coverage, so that there would be no overdraft loan—or fee—until they opted into the service. Likewise, two-thirds of consumers said that banks should deny a debit card or ATM transaction if the checking account balance is too low.

A 2009 Center for Responsible Lending survey found that 80 percent of consumers who wanted a choice about overdraft thought that their debit purchases and ATM withdrawals should only be covered for a fee if they affirmatively asked for overdraft coverage for those transactions. But the default arrangement for most institutions continues to be coverage—whether or not the account holder asked for it.

In addition to wanting to opt-in for overdraft coverage, consumers want to be warned when ATM withdrawals will trigger an overdraft. CFA's 2009 ORCI poll found that 85 percent of adult Americans want banks to be required to disclose on the ATM screen when a withdrawal will overdraw an account. Seventy-three percent strongly supported that requirement. In a 2004 CFA poll, consumers by a wide margin said they are treated unfairly when banks permit them to overdraw at the ATM without warning. The 2004 ORCI survey also found that an overwhelming majority (82 percent) of consumers thought permitting overdrafts without any notice at the ATM was unfair, while 63 percent said it was "very unfair." Fewer than one in five (17 percent) people thought it was fair.

The *Consumer Reports* National Research Center poll also found that many consumers do not expect their bank to pay a debit card or ATM transaction that overdraws an account. Forty-eight percent of those polled thought an ATM card would not work if the account balance was too low and another 10 percent thought they would not be assessed a fee if the bank allowed the overdraft. Thirty-nine percent of people thought their bank would either deny a debit transaction or allow it to proceed without charging a fee.[34]

A 2006 study by Forrester Research Group documented that consumers are "irked" by overdraft fees. While 65 percent of consumers with no overdraft fees said they were very satisfied with their banks, only 53 percent of consumers charged

[33] CFA ORCI Poll, July 24–27, 2009.

[34] Consumer Reports National Research Center, Financial Regulation Poll, as filed with the Federal Reserve Board in Reg E Docket R-1343, March 12, 2009.

overdraft fees in the last few months reported being very satisfied.[35] By offering contractual overdraft protection by linked savings accounts, low cost lines of credit, and transfers to credit cards, banks can provide real protection at lower cost to consumers and avoid angering a large number of banking customers.

Overdraft Loans Are Credit but Don't Have Credit Protections

There is no question that overdrafts loans constitute a form of credit. Overdrafts are credit under the Truth in Lending Act (TILA), which defines "credit" as the right to "incur debt and defer its payment." *See* 15 U.S.C. §1602(e). When a bank permits a consumer to use the bank's funds to pay for an overdraft, and then requires the consumer to repay the bank, it is granting the right to incur a debt and defer its payment until the consumer's next deposit.

Involuntary Overdraft Credit

Overdraft loans are unique in that they are one of the few forms of involuntary credit. Banks impose this form of credit on consumers who have not requested it. Furthermore, some consumers may not be aware until they overdraw their account that they are accessing a high-cost credit product. This is especially true in the ATM or debit card context, where transactions that would overdraw an account were previously declined and did not incur a fee.

Indeed, we can recall only one time that consumers were sent loan products without their affirmative opt-in—when creditors sent unsolicited credit cards to consumers in the 1960s.[36] As a result of the outcry over this practice, Congress stepped in, amending TILA in 1970 to ban unsolicited credit cards.[37] According to the Senate report that accompanied this TILA amendment, unsolicited credit cards encouraged consumers to incur unmanageable debt, and many consumers found them an unwarranted intrusion into their personal life.[38] These same problems cited by this Senate report nearly 40 years ago hold true today for unsolicited overdraft loans—they cause severe financial distress and represent an intrusion on the lives of consumers.

Note that in the case of unsolicited credit cards, the consumer at least has to affirmatively and knowingly take action to use the credit card, by making a purchase or taking a cash advance. In the case of overdraft loans, the consumer not only receives credit without requesting it, the consumer often unknowingly and involuntarily uses that credit when she triggers an overdraft, especially in the debit card situation where many consumers don't realize they can overdraw their accounts.

Thus, overdraft loans represent an even worse problem than unsolicited credit cards did nearly 40 years ago. S. 1799 would prohibit this "cramming" of overdraft loans on consumers by requiring banks to obtain specific written consumer consent before adding this feature to a bank account for debit purchases and ATM withdrawals.

The Federal Reserve Board Has Failed To Protect Consumers Under Truth in Lending

As discussed above, overdrafts are clearly "credit" under the Federal Truth in Lending Act (TILA). The reason that overdraft loan programs do not require TILA disclosures is an exemption created by the Federal Reserve. Regulation Z, which implements TILA, excludes overdraft fees from the definition of a "finance charge." This exemption, written in 1969, was originally designed to exclude from TILA coverage the traditional banker's courtesy of occasionally paying overdrafts on an *ad hoc* basis as a customer accommodation. However, banks exploited this exemption as a gaping loophole, creating and promoting predatory credit, extended on a routine basis without adequate disclosure—contrary to the clear statutory language and intent of TILA. The new Reg E rule maintains the special carve-out from TILA for the debit-card based overdrafts covered. As a result, S. 1799 would amend TILA itself to define an overdraft fee as a finance charge to ensure that institutions no longer benefit from a loophole to exploit account holders and that all short-term consumer lending operates by the same set of rules.

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[35] CUNA News: "Consumers Ignore ATM Fees, Get Irked at Overdraft Fees," January 17, 2006.

[36] Note that a "stickiness" of default options was observed with respect to unsolicited credit cards, which is the same with unsolicited overdraft loans. When unsolicited credit cards were permitted, very few consumers opted out—only 1 percent returned the card. However, when prospective customers were asked whether they wanted to receive a card, only 0.7 percent said they would. Jack Metcalfe, "Who Needs Money", *New York Sunday News,* Nov. 24, 1968, reprinted in 115 Cong. Rec. 1947, 1951 (Jan. 23, 1969).

[37] Pub. L. No. 91-508, 84 Stat. 1126-27 (Oct. 26, 1970).

[38] S. Rep. No. 91-739, at 2-44 (1970).

Consumers Need "Truth" in Overdrafts To Make Informed Decisions

A requirement that banks comply with TILA and quote an effective APR for overdraft loans would be an eye-opener for the extreme high cost of these loans. In general, the fees for overdraft loans translate into APRs that are triple-digit or even higher. For example, consider a $100 overdraft loan that is repaid in 2 weeks, for which the bank charges a $20 fee. A comparable payday loan would have to disclose an APR of 520 percent. Instead of requiring TILA disclosures, the Board chose to regulate overdraft loans under the less effective Truth in Savings Act (TISA), simply requiring disclosure of the fee and a running tally. *See* Regulation DD, 12 C.F.R. Part 230.

Furthermore, most overdraft loans are paid much more quickly than 2 weeks—sometimes in a matter of days or hours—and sometimes the loan is only for a few dollars. The FDIC study gave a more realistic example of the extreme cost of fee-based overdraft. The typical $20 debit card overdraft with a $27 fee repaid in 2 weeks costs 3,520 percent APR if calculated as a closed-end loan. Bank overdraft loans are parallel to payday lending in that the high interest rates and short repayment time often trap marginally banked consumers in a cycle of debt. Consumers should not have to pay triple or quadruple-digit interest rates for either form of credit. (*See* Appendix D).

The failure of the Federal Reserve to require TILA disclosures and other protections for overdraft loans undermines the statute's key purpose of strengthening "competition among the various financial institutions and other firms engaged in the extension of consumer credit."[39] Without the uniform disclosure of the APR required by TILA, consumers have no way to compare overdraft loans to the cost of an overdraft line of credit or transfer from savings. Under the Fed's rules, the disclosed APR for a typical payday loan is 391 percent to 443 percent[40] but for an overdraft loan program the lender may disclose under TISA that the account is actually earning interest! Without apples-to-apples comparisons, there is no competition to reduce the cost of any of these products.

Legislation is needed because the Federal Reserve Board has failed to protect bank customers from abusive overdraft practices or to require financial institutions to comply with credit laws that apply to other forms of small lending or substitute products.

The new rule announced by the Federal Reserve last week amends Reg E and is substantially weaker than the provisions of S. 1799. The Board's rule does not recognize that overdrafts are extensions of credit that should require Truth in Lending disclosures, does not prohibit bank manipulation of the clearing of transactions to maximize overdraft fees, and places no limits on the number of overdraft fees banks can impose. The Federal Reserve's Reg E rule also does nothing to curb excessive fees. Industry calls for Congress to defer to a narrow Federal Reserve rule-making should be ignored. Opt-in alone is not sufficient protection. Consumers also get to "opt-in" to using credit cards, but legislation was needed to curb abusive practices as well.

Overdraft Lending Cost Americans $24 Billion in 2008

Americans pay more in abusive overdraft loan fees than the amount of the loans themselves, paying almost $24 billion in fees in 2008 for only $21.3 billion in credit extended.[41] High fees, coupled with small overdrafts, result in consumers paying more to borrow from banks than the banks extend as credit.

Overdraft loan fees now make up 69 percent of all overdraft-related fees, while traditional NSF fees—generated when the paper check transaction is denied—make up only 31 percent.[42] The FDIC reports that all banks collected service charges on deposit accounts as of June 30, 2009, that totaled $21,796,013,000. Projected to a full year, banks will take in almost $43.6 billion in bank account service charges. According to the FDIC report on overdrafts, about 74 percent of that line item on call reports is generated solely by insufficient fund fees and overdraft fees. If trends continue, consumers will pay banks $32.26 billion due to lack of sufficient funds to cover transactions. At 69 percent of that total, American consumers will pay banks

[39] 15 U.S.C. §1601(a)

[40] Keith Ernst, *et al.,* "Quantifying the Economic Cost of Predatory Payday Lending", Center for Responsible Lending (December 18, 2003), at 3.

[41] 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 9 (June 2007), available at *http://www.responsiblelending.org/issues/overdraft/reports/page.jsp?itemID=33341925'* [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 CRL's database and methodology, *See,* "Out of Balance" at 13-14.

[42] "Out of Balance", at 10.

alone almost $22.3 billion for overdraft loans in 2009. Credit union overdraft fees add to that total.

Small Dollar Overdrafts Trigger Steep Fees

The FDIC's report on bank overdraft loan programs, fees and practices, based on a detailed study of 462 FDIC-supervised banks and data on overdraft transactions from 39 banks, found that the typical debit card purchase overdraft was only $20 but cost an average $27 fee at FDIC banks. If repaid in 2 weeks, that overdraft costs 3,520 percent APR. The typical $60 ATM withdrawal on insufficient funds costs 1,173 percent APR. The median size check that overdraws an account is $66, an APR of 1,067 percent.[43] If the bank adds a "sustained overdraft fee" or requires repayment in less than 2 weeks, the APRs on these loans are even higher. Furthermore, because consumers often use their debit cards several times per day, multiple fees will be charged when an account is overdrawn.

CFA's 2009 survey of the Nation's largest banks confirms that not only are multiple overdraft fees becoming more common, but the fee per transaction is getting larger. The maximum overdraft fee at this sample of banks is now $39, while the median fee is $35. Five of the largest banks use tiered fee schedules, with fees rapidly escalating when consumers incur more than a few overdrafts over a 1-year period. U.S. Bank charges $19 for the first overdraft, $35 for the second through fourth, and $37.50 thereafter. Fifth Third Bank switched to tiered fees in the last year, now charging from $25 to $37 per overdraft. Bank of America terminated its tiered fee structure and now charges $35 for each incidence.

Majority of Largest Banks Double Up on Overdraft Fees

Ten of the sixteen largest banks add sustained overdraft fees when consumers are unable to pay the overdraft and fee within a few days. On top of already high initial overdraft fees, SunTrust adds a $36 additional fee while Bank of America and Citizens Bank add a $35 fee when overdrafts are not repaid in less than a week. Chase Bank adds up to $25 per overdraft when an overdraft goes unpaid for 5 days. When initial overdraft fees and sustained overdraft fees are combined for overdrafts unpaid after 7 days, consumers can be charged as much as $74 at Citizens Bank for a single overdraft. The combined cost at Bank of America is $70, at SunTrust $72, and at U.S. Bank $69.50. In recently announced changes to overdraft programs, six of the largest banks lowered or set a maximum on the number of overdraft fees charged on a single day. For banks with a limit on daily fees, the range is three to seven overdraft fees levied. (*See* Appendix B.)

Voluntary Bank Overdraft Changes Are Too Little, Too Late

Recently announced changes in overdraft programs by some large banks are unlikely to significantly reduce costs to customers. Some banks have changed the threshold that triggers overdraft fees to a total of $5 to $10 in total overdrafts per day before fees are charged and some have lowered the total number of overdraft fees a consumer can be charged in one day. But none of the banks are lowering the fees charged for initial or sustained overdrafts.

While a few banks will soon permit consumers to opt-in for some forms of overdraft coverage, the norm is to permit current customers to opt-out and to only permit new customers to make choices about overdraft loans at those banks announcing changes. It has taken some of the largest banks in the country 4 years to get around to complying with the Interagency Guidelines for overdrafts, issued in 2005, that advised banks to at least provide an opt-out opportunity for consumers. Chase Bank plans to permit its existing and new customers to affirmatively sign up to use overdraft loans and will process payments as they come in during the day. In some cases, banks will permit only new customers to opt-in to some forms of overdrafts in the future. In a change initiated in the last year without fanfare, Citibank does not permit its customers to incur overdrafts when using debit cards for purchases or at ATMs, although Citibank customers can incur four $34 overdraft fees per day for checks. Citibank does not charge sustained overdraft or tiered fees.

Other banks have also announced adjustments to their overdraft practices. For example, Capital One, starting in early 2010, will not charge fees if consumers overdraw their accounts by a total of $5 or less in a single day and will limit the number of overdraft fees to four per day. Capital One permits customers to opt-out of having overdrafts paid for a fee. Starting mid-2010, Capital One will permit new account holders to decide whether to opt-in to overdrafts triggered by debit cards and at ATMs. (*See* Appendix A: Summary of Recent Changes to Bank Overdraft Practices and Prices.)

[43] FDIC Study at v.

S. 1799 Protects Bank Account Customers

S. 1799, the FAIR Overdraft Coverage Act, will prevent abuses created by the relatively new system of unauthorized fee-based overdraft lending that is premised on generating fee revenue rather than protecting the funds of account holders. This important legislation places bank overdraft lending on the same legal playing field as other forms of small-dollar loans and provides consumers with information necessary to make an informed decision.

S. 1799 requires financial institutions to obtain account holders' specific written consent in order for financial institutions to enroll them in fee-based overdraft programs triggered by debit cards at point of purchase and ATM withdrawals. We also support requiring affirmative consent for overdraft coverage triggered by checks, preauthorized debits, and other ways funds are spent from consumers' accounts. This control over bank account credit features is what consumers expect and want to have.

S. 1799 requires banks and credit unions to warn account holders before making them a high-cost loan at the ATM or from a teller and permits them to terminate the withdrawal to avoid the fee. This warning is what consumers expect and want. A GAO study is mandated to explore the feasibility of point-of-sale warning and ability to terminate a debit purchase in the future.

S. 1799 prohibits manipulation of account activity if the result is to increase overdrafts. This should mean no debiting accounts with the highest dollar charge first in order to increase the number of overdraft fees an account holder is charged and no holding deposits before crediting accounts in order to create a negative balance and charge an overdraft fee. Bank manipulation of payment order is strongly opposed by consumers.

S. 1799 also clarifies that an overdraft fee is a finance charge subject to the Truth in Lending Act. This will confer TILA protections to overdraft loans and require cost-to-borrow disclosures as determined by the Federal Reserve. The Board will need to devise disclosures that provide consumers with comparable cost to borrow information.

S. 1799 requires the Federal Reserve Board to set "reasonable and proportional" bank overdraft fees, based on the cost to banks to cover these loans. Competition has had no impact on bank overdraft fees that continue to escalate even in a recession. This feature of S. 1799 is comparable to the CARD Act's requirement that the Board set the over-the-limit fee.

S. 1799 protects consumers from being buried in overdraft fees and requires banks to provide information on their less expensive and more appropriate products available to address overdrafts or extend small dollar loans. The bill applies the FDIC's payday loan suitability standard [44] as well as the over-the-limit policy in the CARD Act by limiting banks to one overdraft fee per month up to a total of six per year. The bill permits banks to cover more overdrafts without charging additional fees. Banks can and should reject debit card purchases or ATM withdrawals for which funds are not available, which was standard banking practice just a few years ago. A cap on the number of overdraft fees that can be charged is not an invitation for consumers to initiate numerous unfunded transactions. In fact, limiting banks to one fee per month gives banks a financial incentive to limit unfunded purchases and withdrawals.

S. 1799's one-fee-per-month limit will prevent banks from piling on sustained overdraft fees when consumers are unable to repay the overdraft and initial fee in just a few days. Not only will this limit protect frequent users of overdrafts, it will provide an incentive for financial institutions to market their more affordable and appropriate products such as overdraft lines of credit, transfers from savings, and small dollar loans.

We also urge the Senate to enact Senator Dodd's legislation to create the Consumer Financial Protection Agency to provide a strong consumer protection agency for financial services. The CFPA will be assigned the job under Truth in Lending to write the rules that implement the FAIR Overdraft Protection Act, to supervise

[44] FDIC Guidelines for Payday Lending, 2005, Renewals/Rewrites amended the Retail Classification Policy, directing institutions to "Ensure that payday loans are not provided to customers who had payday loans outstanding at any lender for a total of three months during the previous 12 months . . . What a customer has used payday loans more than three months in the past 12 months, institutions should offer the customer, or refer the customer to, an alternative longer-term credit product that more appropriately suits the customer's needs. Whether or not an institution is able to provide a customer alternative credit products, an extension of a payday loan is not appropriate under such circumstances." *See: www.fdic.gov/news/news/financial/2005/fill405a.html,* viewed 3/2/2005. Since payday loans are typically 2 weeks in duration, a three month payday loan limit is equivalent to permitting six monthly overdraft fees per year.

compliance with these new protections, and to provide consumer information. The Federal Reserve has failed to adequately exercise its authority to protect consumers from unfair and abusive overdraft loan practices.

Conclusion

Today, as many American families struggle to meet daily obligations in the worst economy since the Depression, the last thing they need is to be surprised by high-cost credit to which they never expressly consented. S. 1799 would benefit consumers by requiring financial institutions to get consumers' affirmative and informed consent to select fee-based overdraft programs for debit card purchases and ATM withdrawals; defining overdraft fees as a finance charge covered by Truth in Lending; capping fees based on Federal Reserve rules using reasonable and proportional costs to cover an overdraft; and limiting overdraft fees to one per month up to six per year. Overdraft loans are not a "convenience," but are dangerous high-cost loans that must be reined in, even for people who agree to use them. We urge this Committee to reverse the drain on vulnerable consumers' bank accounts and the current trend toward even greater overdraft abuses by supporting S. 1799.

Appendix A

Summary of Recent Changes to Bank Overdraft Practices and Prices

These descriptions of recent changes to bank overdraft programs are based on bank press releases, information posted on bank websites, and news stories.

Bank of America will not charge overdraft fees if the total amount overdrawn in a day is less than $10. The bank is reducing the total number of overdraft fees it can impose in a single day from the current ten to four. As recently as February of this year, however, Bank of America had limited the number of overdrafts to five per day.

When the changes took effect October 19th, a Bank of America customer who overdrew on four transactions that totaled $10 or more would be charged $35 for each overdraft for a total of $140. If that customer is unable to repay in five days, she will be charged another $35 sustained overdraft fee for each unpaid overdraft up to $140 for a total of $280 in fees for as little as $10 in overdrafts for less than a week of credit.

Next June, Bank of America will make it easier for customers to opt out of using overdraft loans and will permit only new customers to opt in for overdraft loans. Bank of America did not announce a change to its current practice of manipulating transaction order by paying largest transactions first, a practice that can increase the number of overdraft fees consumers pay.

BB&T is changing its overdraft practices for debit cards and ATM withdrawals starting the first quarter of 2010 and will not charge fees for overdrafts totaling $5 or less in a day. The bank, which currently has no limit on the number of fees it charges per day, will limit overdraft fees to four per day. The bank will start alerting ATM users when a withdrawal will overdraw the account. The bank currently permits customers to opt out of overdraft coverage.

BB&T charges $35 per overdraft and adds a $30 sustained overdraft fee if not repaid in seven days. When the changes take effect, the bank will be able to charge up to $140 per day for four overdrafts that total $5.01. If customers are not able to repay four overdrafts plus $140 in one week, the bank will charge another $120 in sustained fees for a total cost of $260 for as little as $5.01 in credit. BB&T is not providing its customers the right to affirmatively opt in to overdraft loans, but only permits customers to opt out.

Chase announced that it will give its 25 million current and new accountholders the right to opt in to overdrafts triggered by a debit card, but not for checks and other transfers. Debit card transactions and ATM withdrawals will be posted as they occur, which the bank expects will result in fewer fees. Chase will not charge its overdraft fee for overdrafts of $5 or less in a day and is reducing the maximum number of overdraft fees from six to three per day. Chase says that it denies ATM transactions that exceed the available funds in the account.

Chase has a tiered overdraft fee schedule, with the first overdraft in a year costing $25, the next three overdrafts at $32 each, and five or more overdrafts in a year at $35 each. Chase also adds a sustained overdraft fee if an overdraft is not fully repaid in five days. This second fee varies across the country, with a maximum of $25. As a result of the announced changes, a consumer who has three overdrafts in a day totaling $5.01 will owe the bank $89 if these are the first overdrafts in a year. If the customer has overdrawn at least four times in the past year, three overdrafts cost $105 with sustained fees adding another $75 for a total $180 for as little as $5.01 borrowed for less than a week.

Regions Bank is also setting a $5 total overdraft trigger for charging overdraft fees and limiting the number of overdraft fees per day to four, effective the first quarter of 2010. The bank permits customers to opt out of overdrafts and alerts ATM users that a withdrawal could create an overdraft. Regions Bank waives the first overdraft fee a customer triggers, then charges tiered fees for any subsequent overdrafts. The first fee in a year is $25, the next two overdrafts cost $33, and four or more overdrafts in a year's period cost $35 each. As a result of the announced changes, after the first overdraft in the customer's history with the bank, the bank will be able to charge a total of $126 for four overdrafts of $5.01 or more total in one day.

US Bank's changes as of the first quarter 2010 include a $10 threshold of total overdrafts per day to trigger an overdraft fee and a three overdraft fees per day limit. Currently, US Bank permits up to six overdraft fees to be charged in one day. US Bank charges tiered overdraft fees, starting at $19 for the first one, $35 for two to four, and $37.50 for five or more in a year, the highest fee charged by the sixteen largest banks surveyed by CFA in July. A customer with three overdrafts in a day will owe $89 for the first incident. If the customer has overdrawn four times in the past year, total fees for three overdrafts will be $112.50 for as little as $10.01 borrowed.

US Bank announced it would permit current customers to opt out of using overdraft loans and new customers the ability to opt in having overdrafts paid for a fee. The bank will set an annual unspecified cap on the total amount of overdraft fees that can be assessed on a single account and will evaluate its order of posting payments to accounts. Currently, the bank pays the largest transactions per day first, which can trigger more fees.

Wells Fargo and **Wachovia** customers will not be charged overdraft fees if the total amount overdrawn per day is $5 or less and will limit the total number of overdraft fees per day to four. Wells Fargo currently permits ten overdrafts per day and Wachovia has no maximum. Wells Fargo and Wachovia customers will get to opt out of having overdrafts paid for a fee, but do not get the right to opt in. Wells Fargo charges $35 per overdraft as does Wachovia as of July. As a result of the announced changes, bank customers can be charged $140 in overdraft fees for as little as $5.01 in four overdrawn transactions.

Appendix B

Update to CFA July 2009 Survey of Overdraft Fees

CFA issued a survey of overdraft fees as of late July. This survey is updated to show banks' announced overdraft program changes to these terms in **bold**.

Bank	OD Fee	Sustained OD Fee	Maximum Daily Fees
Bank of America	$35	$35 after 5 days	**4 per day**
BB&T	$35	$30 after 7 days	**4 per day**
Chase	$25 first OD $32 2 to 4 OD $35 5 or more	0 to $25 per OD after 5 days	**3 per day**
Citibank (Does not permit overdrafts by debit card)	$34	None	4 per day
Citizens Bank	$25 first OD $37 2nd OD day $39 3 or more	$35 after 6 days $35 2nd fee/ 10 days	No Max
Fifth Third Bank	$25 first OD $33 2 to 4 OD $37 5 or more	$8/day after 3 days	No Max
HSBC	$35	None	No Max
National City Bank	$30 to $36	None	No Max
PNC Bank	$31 1 to 3 OD $34 4 to 6 OD $36 7 or more	$7/day after 4 days Max $35 sustained	No Max
Regions Bank	$25 first OD	None	**4 per day**
SunTrust	$36	$36 on 7th day	No Max
TD Bank	$35	$20 on 10th day	6 OD and 6 NSF
US Bank	$19 first OD $35 2 to 4 $37.50 5 or more	$8/day after 3 days	**3 per day**
WAMU	1 free OD $34	None	7 OD
Wells Fargo/ Wachovia	$35	None	**4 per day**

Appendix C

Federal Bank Regulatory Agencies Failed to Stop Processing Order Manipulation

The Comptroller of the Currency permits national banks to rig the order in which debits are processed. When national banks began to face challenges in court to the practice of clearing debits according to the size of the debit -- from the largest to the smallest --rather than when the debit occurred or from smallest to largest check, the OCC issued guidelines that allow banks to use this dubious practice.

The OCC issued an Interpretive Letter allowing high-to-low check clearing when banks follow the OCC's considerations in adopting this policy. Those considerations include: the cost incurred by the bank in providing the service; the deterrence of misuse by customers of banking services; the enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and the maintenance of the safety and soundness of the institution.[45] None of the OCC's considerations relate to consumer protection.

The Office of Thrift Supervision (OTS) addressed manipulation of transaction-clearing rules in the Final Guidance on Thrift Overdraft Programs issued in 2005. The OTS, by contrast, advised thrifts that transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees.[46]

The Guidelines issued by the other federal regulatory agencies merely urged banks and credit unions to explain the impact of their transaction clearing policies. The Interagency "Best Practices" state: "Clearly explain to consumers that transactions may not be processed in the order in which they occurred, and that the order in which transactions are received by the institution and processed can affect the total amount of overdraft fees incurred by the consumers."[47]

CFA and other national consumer groups wrote to the Comptroller and other federal bank regulators in 2005 regarding the unfair trade practice of banks ordering withdrawals from high-to-low, while at the same time unilaterally paying overdrafts for a fee. One of the OCC's "considerations" is that the overdraft policy should "deter misuse of bank services." Since banks deliberately program their computers to process withdrawals high-to-low and to permit customers to overdraw at the ATM and when making purchases with debit cards, there is no "misuse" to be deterred.

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[45] 12 C.F.R. 7.4002(b).
[46] Office of Thrift Supervision, Guidance on Overdraft Protection Programs, February 14, 2005, p. 15.
[47] Dept. of Treasury, Joint Guidance on Overdraft Protection Programs, February 15, 2005, p. 13.

Appendix D

Bank Overdrafts are Payday Loans

Credit extended to consumers when banks pay transactions that overdraw accounts is very similar to loans made by payday lenders. Payday loans are small cash loans based on the lender holding the borrower's personal check for future deposit on the next payday. Parallels for these two forms of high-cost lending:

- Both require borrowers to have a bank account. Banks permit accountholders that meet threshold qualifications to use overdrafts. Payday lenders require borrowers to have a checking account and to show a recent bank statement in order to obtain a loan.

- Both are based on borrowers writing a check or authorizing a debit for more than the borrower has in the bank. Overdrafts are triggered when a consumer uses a debit card at a retailer, withdraws cash at an ATM, or has a check covered by the bank despite insufficient funds. Payday lenders hold the borrower's personal check or debit authorization as both security for the loan and the means of collecting payment.

- Both are due and payable within a few days. Payday loans are due in full on the borrower's next payday, generally 14 days. Overdraft loans are due and payable immediately. If not repaid within days, some banks add additional fees.

- Both require balloon payments of the full amount of the loan and the fees. If payday loan borrowers do not pay with cash on payday, the lender sends the check to the bank for collection. Banks demand immediate repayment and use set-off to withdraw payment for the overdraft and fees from the next funds deposited into the consumer's account.

- Both loans cost triple or quadruple-digit interest rates. The annual percentage rate for a one-week $200 payday loan at $17.50 per hundred is 910 percent, while a $200 overdraft loan repaid in one week for a $35 fee costs the same. The FDIC reported that a typical $20 debit overdraft, costing $27 fee, repaid in two weeks costs 3,520 percent APR.

- Both put borrowers in a debt trap. The typical payday loan borrower has 9 loans per year and ninety percent of the business is generated by borrowers with five or more loans per year. The FDIC reports that 84% of all insufficient funds and overdraft fees were paid by 8.9 percent of account holders who had ten or more overdrawn transactions in a year.

- Failure to immediately repay loans sets off a cascade of other fees. Payday lenders charge insufficient funds fees when checks are returned by the bank, plus the consumer's bank charges NSF fees each time. Bank collection through set-off may trigger more overdrafts when other payments are presented to the bank. Banks with sustained overdraft fees drive up the cost of the initial overdraft.

- Both products put consumers at risk for losing their bank accounts. Banks typically do not permit overdrawn customers to close accounts until the overdraft and fees are paid. Too many unpaid overdrafts or NSF fees can result in account closure. If the bank account is closed due to repeat overdrafts, this will be listed on credit reports which may prohibit consumers from opening a new bank account. A Harvard Business School study found that use of payday loans increases involuntary bank account closures.

Chart: The High Cost of Bank Overdraft "Payday" Loans

This chart illustrates what a $100 overdraft would cost when the overdraft remains unpaid for seven days, using the bank's maximum fee and the sustained overdraft fees that would be imposed over a seven-day time period. The APR is computed as if this were a closed-end one-week payday loan.

Bank	Max OD Fee	Sustained OD Fee Times # of Days	Total	APR/7 days
Bank of America	$35	$35	$70	3,640%
BB&T	$35	$30	$65	3,380%
Chase	$35	$12.50 (AZ)	$47.50	2,470%
Citibank	$34	0	$34	1,768%
Citizens	$39	$35	$74	3,848%
Fifth Third	$37	4x$8 = $32	$69	3,588%
HSBC	$35	0	$35	1,820%
National City	$36	4x$8 = $32	$68	3,536%
PNC	$36	3x$7 = $21	$57	2,964%
Regions	$35	0	$35	1,820%
SunTrust	$36	$36	$72	3,744%
TD Bank	$35	$20	$55	2,860%
U.S. Bank	$37.50	4x$8 = $32	$69.50	3,614%
Wachovia	$35	0	$35	1,820%
WaMu	$34	0	$34	1,768%
Wells Fargo	$35	0	$35	1.820%

PREPARED STATEMENT OF FRANK POLLACK

President and Chief Executive Officer, Pentagon Federal Credit Union

November 17, 2009

Good afternoon, Mr. Chairman and Members of the Committee. On behalf of the Board of Directors and Management of the Pentagon Federal Credit Union I would like to thank you for the opportunity to testify here today.

The Pentagon Federal Credit Union is a $14 billion credit union serving nearly 950,000 members around the globe. Our core field of membership comprises the men and women of the Army, Air Force, Coast Guard, and Department of Homeland security. We are a conservative institution that is particularly fee averse. Our total fee income represents less than 10 percent of our total income. While our first priority is to always remain safe and sound our strategic objective is to provide products and services that result in high rates on savings, low rates on loans and low fees.

We have been recognized in the military community as a leader with our overdraft protection programs. We have always viewed overdraft protection as a particularly valuable service for the military member. In their line of work maintaining good credit is important to their military readiness and ultimately their career. Thus, our program dates back more than 20 years preceding most of the overdraft programs that have come into question today.

From the very beginning we have believed that members should either qualify for our low cost line of credit or we should not allow over drafting of their accounts. We would note that with more than two decades of experience we find that our members are appreciative of the responsible approach that we have taken. We offer a line of credit attached to a member's checking account with a minimum of $500 overdraft protection. This service is offered to every creditworthy member who opens a checking account. Forty five percent of our active checking accounts have line of credit overdraft protection. As a result our program has always been opt-in. We believe that every consumer must have opt-in rights. At the Pentagon Federal Credit Union we charge 14.65 percent annual percentage rate, calculated on a simple interest basis with no other fees or charges when an overdraft occurs. We believe that by using a line of credit product which is formally recognized as a loan and thus subject to all of the Federal lending disclosure requirements, the cost to the consumer is both fully disclosed and properly proportional to the amount that they overdraft their account by.

At PenFed we post transactions smallest to largest to avoid charging unnecessary overdraft and nonsufficient funds fees. We provide separate mail notifications for each overdraft event so that our members are kept fully aware of the status of their account. We believe rapid notification is important because it enables members to pay off the loan immediately if they are able thus further reducing the cost of the overdraft. In short, we have attempted to craft a product that is truly consumer friendly. We would make note of the fact that we have not received a single complaint from our membership regarding the order in which we process items in more than 20 years.

Nevertheless, there are members who do not choose to opt-in and there are those who can not qualify for a line of credit. These members are not allowed to overdraft their account with the limited exception of an off line debit transaction where we are required, by contract, to process such payments. In those instances we do charge a fee of $30. This does not happen with great frequency and we recognize the proposed bill would eliminate this fee. We support that and we recognize that the recent action of the Federal Reserve Bank will prohibit such a fee. However, we do believe that merchants and networks should also be required to process all transactions in real time which would eliminate this exception circumstance.

As an organization we are constantly focused on process improvement. We felt that there was more that we could do for our military members in the area of overdrafts. This summer we made a decision to eliminate as many of the nonsufficient funds fees that our military members incur as we possibly could. The product we created is called, "Warriors Advantage." It waives the checking account fees associated with instances of insufficient funds for up to two occurrences in any rolling 3 month period. Importantly, this program is separate and distinct from our overdraft line of credit and goes beyond the minimum requirements of the proposed legislation.

Under this program a military member with overdraft protection can use all of the money available in their checking account plus all of their line of credit *and* have two additional instances of returned items every 90 days with no fees or charges beyond the interest on their loan. Our research indicated that this program would result in just over 98 percent of our military membership with checking accounts *never* experiencing a fee!

The Warriors Advantage program represents only a beginning for us. We intend to extend this program to our entire membership and we are already at work on our next version which we hope to roll out in the summer of 2010.

Thank you very much for this opportunity to testify and we are indebted to you for your work on behalf of the American consumer.

PREPARED STATEMENT OF JOHN P. CAREY

CHIEF ADMINISTRATIVE OFFICER, CITIBANK NA

NOVEMBER 17, 2009

Good afternoon Chairman Dodd, Ranking Member Shelby, and Members of the Committee. My name is John Carey, and I am the Chief Administrative Officer of the Citigroup North America Consumer Banking business and am responsible for, among other things, the business practices of Citibank, North America. I appreciate the opportunity to appear before you today to discuss our views on the Fairness and Accountability in Receiving (FAIR) Overdraft Coverage Act (S. 1977) and to offer recommendations for improving customer choice in and protection by overdraft coverage.

Citibank serves more than 4 million customers in our retail banking business and has a network of more than 1,000 branches, 3,200 Citibank proprietary ATMs, and an additional 23,000 surcharge free ATM's available to our customers through various partnerships.

As we will discuss today, the policies that most banks employ when applying overdraft protection policies, most particularly for ATM transactions or debit purchases, can be very confusing, frustrating, and too expensive for consumers, particularly for those people who don't closely manage their daily finances. We have all heard stories about consumers being caught unaware and incurring unexpected fees for transactions they could have easily avoided with greater transparency at the point of sale.

So let me be clear—at Citibank, we help customers avoid overdraft fees. We decline ATM transactions or debit purchases when sufficient funds are not available to cover the transactions. Therefore we do not charge overdraft fees when a customer attempts such a transaction.

At Citibank, we believe that we have an obligation to our customers to be fair and fully transparent and to use practices and disclosures that are clear and easy to understand. In many cases, overdraft fees can be avoided. To that end, I will highlight some important observations about consumer behavior and preferences describe our position and practices relative to overdraft protection, address some of the key aspects of the current bill that will adversely affect our customers and the industry at large, and offer some solutions for how consumer concerns around overdraft services could best be addressed.

When banks enter a relationship with a consumer, they take on a significant responsibility: to provide tools and services that make fundamental day-to-day financial activities easier, more convenient, and beneficial to consumers, while providing value to customers for the value they bring to banks with their business. Most banks provide their customers with instant access to their funds through branches, ATMs and online banking services. Moreover, most banks provide their customers with financial expertise and assistance through their representatives and a wide range of tools that support better money management.

At the same time, it is impossible to provide a wide variety of banking services to the public without assuming some risk. Therefore, it is the responsibility of both the customer and the bank to work together to mitigate those risks. The services that banks provide regarding overdrafts are an important component of the basic banking relationship and in mitigating risk. Responsible money management ultimately must lie in the hands of the consumer, because it is the individual consumer who has immediate control and knowledge of his finances and accounts. We recognize, however, that it may not always be practical for customers to keep track of every purchase. There are ways to make purchases that operate in different time frames (for example, instant PIN debit purchases *versus* check processing or scheduled payments), and merchants have a wide range of processing options that add complexity, so banks have widely instituted the service of occasionally covering transactions through overdraft payments.

In thinking about overdraft services, it is important to distinguish ATM transactions or debit purchases from other transactions such as checks and Automated

Clearing House (ACH) transactions. The frustration that consumers express is centered on those ATM or debit transactions where the overdraft fee could have been avoided, if the customer had only known at the ATM or point of sale that the transaction would result in the assessment of an overdraft fee.

Conversely, customers find overdraft services for checks and ACH transactions to be a valuable service. They prefer to have their bank cover the occasional overdraft payment of a check for a fee, rather than having the check returned, receiving an insufficient funds fee, an additional bounced check fee imposed by a merchant for the returned item, and the possibility of negative impact to their credit report.

Overview of Citibank Overdraft Policies and Practices

For Citi, our guiding principle to overdraft payment services is simple: we help our customers effectively manage their finances and avoid spending money they don't have in their accounts. That's why for ATM transactions or debit purchases (both PIN-based and signature-based), where balances can be instantly checked electronically, we will not authorize a transaction when the customer does not have the funds to spend in his account.

Separately, we do allow overdrafts for checks and ACH transactions. We do this because the situation is very different. With checks and ACH transactions, the customer has the sole control over those transaction requests; we cannot know what amount they are writing on a check or exactly when they have written the check. In those cases, we mitigate risk for our customers and ourselves by allowing customers a cushion that covers a small overdraft. In order to avoid large overdraft situations, Citi will not authorize payment beyond a reasonable amount.

Moreover, we encourage customers to link other accounts or lines of credit to cover potential overdrafts and avoid either an overdraft fee or a bounced check fee. Overdraft/NSF fees help cover the cost of processing the transaction, cover the risk of possible loss, cover the cost of an interest-free advance of funds, as well as provide an incentive to customers to not spend more than they have in their account, or to use the other, lower-cost services we have that can cover potential overdraft transactions.

We have also made other important policy decisions to ensure our overdraft protection is fair. We instituted a cap of four fees per day (which also includes insufficient funds fees) in early 2008; fees that for Citibank generally would arise only if a customer drew multiple checks where funds were unavailable. We do not do "continuous overdraft," where a bank will impose an additional fee on an overdraft if the overdraft remains on an account after a certain period of time. Finally, because we track electronic debits instantly, we have established a processing order that is beneficial for our customers.

Customer Needs and the Importance of Choice

As technology has improved and customers expect more choice in their banking, Citibank has gone to great lengths to provide tools to help customers manage their finances. In addition to providing alerts and instant access to balances online and through mobile services, we make sure that our customers' transactions are updated in real time so that customers can move money as needed to cover payments. Our customers are able to see credits or the electronic purchase they made at the grocery store reflected immediately in their available balance. And, we know they avail themselves of this service as a significant number of customers make transfers at branches, online, or at ATMs every day to cover potential overdrafts they are able to see happening during the day.

In addition, a third of our customers have signed up to link a line of credit or savings account to their checking accounts, which can be used to cover overdrafts in addition to simply being used for savings or as additional credit to draw upon. We encourage the establishment of these services at account opening and throughout our relationship with our customers. Our personal bankers are in fact incented to encourage customers to open additional savings accounts and lines of credit to cover overdrafts. When a customer uses these services to cover overdrafts proactively, there are no additional fees charged; when Citi covers the overdraft for them using these accounts or lines, a nominal fee is charged. Finally, many of our customers have signed up for low-balance alerts, which help them avoid unnecessary bank fees.

Today fewer than 20 percent of Citibank customers are charged even one overdraft fee in a year. Of those, only a few are charged more than once annually. We believe a reason for this is due to our practice of NOT authorizing ATM and Debit transactions when funds aren't available. Fortunately, our customers continue to do a good job of managing their accounts, and, with tools such as the ones we offer to protect them from overdrafts, we believe that behavior will continue. Still, it is our fundamental belief that choice and control around overdraft fees should lie squarely in the hands of informed customers.

Views on Pending Legislation

In general, we fully support the bill's goals of protecting consumers from unnecessary overdraft fees. We believe that consumers need transparency, especially at the transaction point in order to make informed choices about incurring such fees. That is why we support additional efforts to improve consumer awareness regarding overdraft protection and alternative payment options to help people be smart and responsible about money management.

Moreover, we agree that banks should provide more transparent and easy-to-understand disclosures so that consumers can better manage their own money. For us, meaningful customer choice and control are paramount, and customers should be able to choose if they need to overdraft or not.

We also believe, however, in the importance of giving customers the ability to make choices based upon their individual circumstances as they manage their finances from one day to the next. That is why we support a requirement for interactivity of ATM screens that allow customers to choose whether to continue with a transaction and pay a fee for insufficient funds or terminate the transaction. We also see enormous value in finding a similar solution for debit transactions. We believe that the recent changes to Regulation DD that will go into effect in January of next year, requiring statements to tally overdraft and insufficient funds fees for customers annually, will go a long way towards raising further awareness about the costs to consumers for spending funds they don't have.

Our concerns regarding the bill are as follows:

Opt-in and Notification Requirements

Most customers do not overdraft and never will. However, customers may not fully understand the effect that opting into or out of overdraft coverage will have on them when they open an account and choose not to "opt-in" to overdraft coverage. In the future they may find themselves in a circumstance where they wish they could proceed with a specific transaction even if they know they would be charged a fee. So for example, it isn't that $5 cup of coffee that ends up costing $40, but rather that being stranded without cash in a foreign country and being able to access $100 from an ATM that will cost them $135. Having previously "opted-out" would eliminate that flexibility.

So it is our position that customers should be given the choice of "opting-in" at the point of transaction instead. Customers should be alerted when an ATM or debit transaction will overdraft an account, and they should be able to choose at that moment whether they need to continue with that transaction and incur the associated fee or not.

Understandably, updating the technology to provide such transparency will take time and it will be incumbent upon the merchants, the networks, and the banks to help create the functionality allowing for this practice at the transaction point.

Until then, perhaps all banks should be required to deny ATM and debit transactions that will trigger an overdraft fee, a practice that Citi follows today. Giving the customer the choice to overdraw and incur the fee at the time of the transaction—the moment of truth—we believe, provides the best possible notice. In the absence of the technology to provide this notice, the transactions should simply be denied.

Separately, we have concerns about the same-day notification requirements contained in the bill, especially given the amount of detailed information that would be required. This kind of notification would be nearly impossible to achieve technologically, and additionally may not be relevant, above and beyond communication tools that already exist. By way of example, many customers overdraft their account early in the day, but through the course of the day have either made transfers or deposits to cover the overdrafts. This tells us that these customers are managing their financial circumstances appropriately, making the communication potentially unnecessary or even inaccurate. Because many transactions such as checks are received after hours and most ACH transactions are processed overnight through posting reconciliation, a notification would not be timely enough for the customer to respond. In the final analysis though, we believe that customers should manage their finances effectively and use the many tools we already provide to achieve those goals.

Limitation of Fees Assessed to One Per Month and Six Per Year

The bill's provision that would limit the number of fees assessed is complicated by network merchants' rules that govern how banks process certain transactions. Many times a bank cannot control and therefore must allow overdrafts. The most prevalent example of this is for settlements of signature-based debit transactions. If this limitation is meant to impose restrictions on practices such as "continuous overdrafts," it also has the consequence of preventing banks from collecting appropriate compensation for transactions they are required to honor with merchants, but bear the entire risk of potential losses. It is impossible for banks to predict which customers will be responsible for those losses, so a very real result may be that banks eliminate payment of overdrafts, including checks and ACH transactions, so that some of the settlement risk is covered. Again, the result will be harm to customers through additional merchant fees and the consequences of unpaid bills. For customers who intentionally and fraudulently create overdrafts, they would soon learn that they can "get away" with doing so at a fixed cost to them, which eliminates the effectiveness of overdraft fees as a deterrent.

We suggest that if the bill is attempting to limit "continuous overdraft" fees for a single overdraft, the legislation be focused to specifically address that practice. Moreover, we believe that by requiring customer choice at the ATM or point of sale whether or not to incur an overdraft fee before authorizing a transaction, customers are in complete control. Absent that choice, the transaction should not be authorized. Finally, for ATM transactions or debit purchases, we believe that the limitation on fees should apply only to those fees incurred through ATM transactions and debit purchases and not apply to ACH and check transactions.

Limitation on Fees Created by Holds and Settlements

Since authorization amounts, or holds, are entirely controlled by merchants, banks have no way of anticipating the actual intentions of customers when they are performing a transaction. Two common examples of this are gas station purchases and hotel stay purchases. Although a gas station may only authorize $1 to allow a customer to pump gas, the settlement amount will almost always be larger. In this case, we believe that merchants should request authorizations that are greater than $1 and indeed ought to consider an amount closer to the average transaction purchase at the pump. This should be an easy change for gas stations to make, and it would go a long ways towards reducing customer inconvenience. Moreover, at some level, the customer must also accept responsibility for knowing whether or not they have sufficient funds in their account to buy the gas. Banks can only authorize what is presented to them by the merchant, and have no way of knowing for what amount the ultimate transaction will settle.

In the case of a hotel stay transaction, the merchant may seek authorization for an amount that exceeds the cost of the customer's actual stay, and only the merchant is in a position to know or communicate to the customer what the amount of the hold will be and ultimately the amount of the settlement. Regardless, banks must in the meantime continue to process other intervening transactions based upon the authorization request that was submitted by the hotel. This challenge was recognized by the Federal Reserve Board in its recent amendment to Regulation E. These issues could be minimized through changing the way merchants process these transactions, by either seeking authorizations that more closely reflect the cost of the ultimate transaction or changing the way they process the transaction. We believe that some effort should be put into developing better controls and rules regarding merchant hold processing, and providing guidelines that could be much more effective in terms of protecting consumers.

"Reasonable and Proportional Costs"

The bill recommends that a study be performed to understand what the reasonable and proportional costs are of overdraft protection to overdraft fees. Our request is that the study address all costs associated with overdraft procedures, certainly including risks and losses, but also including additional costs born today. For example, on a daily basis we review accounts and intervene on behalf of good customers before overdraft fees are assessed, and if the report were not to factor such overhead costs, we may have to stop providing that type of customer service. Moreover, we believe that if the bill actually prohibited overdraft ATM transactions or debit purchases (both PIN-based and signature-based) unless the customer has the opportunity to opt-in at the point of sale, the debate around the reasonable and proportional costs gets clearly placed in the consumer marketplace rather than through Government imposed price controls.

Posting Order

We strongly believe that our posting order presents a fair and simple means of processing customer transactions, which they can easily understand. The problems that consumers report are when all transactions are bundled and then processed from high to low. We believe that by processing credits first, electronic payments as they come in, and then processing ACH transactions and checks from high to low, overdraft fees are minimized and the important transactions such as mortgages and car payments are covered. This practice is in our customers' best interests. Attempting to process all transactions chronologically, particularly with checks, would be very difficult, as checks are processed in batch, and we do not know what the customer's particular intentions were regarding order of payment.

Conclusion

As I have noted, we find merit to the overriding goals of this bill and we believe that customers should have informed choices before incurring debit overdraft fees. Obviously, the ultimate goal is for customers to manage their finances carefully and never overdraw their accounts. Nevertheless, for the reasons noted above, we believe that the legislation may not fully address the concerns that consumers have with debit card overdraft fees.

Thank you for the opportunity to share our ideas with you.

PREPARED STATEMENT OF MICHAEL CALHOUN

PRESIDENT, CENTER FOR RESPONSIBLE LENDING

NOVEMBER 17, 2009

Good afternoon Chairman Dodd, Ranking Member Shelby, and Members of the Committee. Thank you for inviting me to testify on S. 1799, the "Fairness and Accountability in Receiving (FAIR) Overdraft Coverage Act of 2009." The Center for Responsible Lending enthusiastically supports this bill as a crucial measure for protecting consumers from abusive bank overdraft fees.

I am president of the Center for Responsible Lending (CRL), a not-for-profit, nonpartisan research and policy organization dedicated to protecting home ownership 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 nonprofit 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 $5.6 billion in financing to more than 62,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the United States.

Self-Help has operated a North Carolina-chartered credit union since the early 1980s. In 2004, Self-Help Credit Union (SHCU) merged with three community credit unions offering a full range of retail products,[1] and it now services over 3,500 checking accounts and approximately 20,000 other deposit accounts.[2] In 2008, Self-Help founded Self-Help Federal Credit Union (SHCU) to expand Self-Help's scope of work. SHCU does not offer a fee-based overdraft program, and it routinely denies debit and ATM transactions when the customer does not have sufficient funds. 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, with no transfer fees.

In my testimony, I will describe the explosion of overdraft fees in recent years and the lack of meaningful action by bank regulators to curb these abuses. I will also summarize the reforms needed to stop unfair overdraft practices and explain how S. 1799 would implement these reforms.

I. Overdraft Fees Have Exploded in Recent Years

Overdraft fees are the fees charged when an institution chooses to pay a customer's debit card, check, ATM or other electronic transaction, even though the customer's account lacks sufficient funds to cover the charges. In 2008, overdraft fees cost consumers $23.7 billion, and we project that in 2009, fees will reach $26.6 billion.[3] In 2004, these fees were $10.3 billion—which means they are now a whopping two-and-a-half times the size they were just 5 years ago.[4] Overdraft fees paid now

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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.

[3] Leslie Parrish, "Overdraft Explosion: Bank Fees for Overdrafts Increase 35 Percent in 2 Years", Center for Responsible Lending (Oct. 6, 2009), available at *http://www.responsiblelending.org/overdraft-loans/research-analysis/crloverdraft-explosion.pdf* [hereinafter Overdraft Explosion].

[4] In 2004, CRL first estimated the annual cost consumers paid in overdraft fees at $10.3 billion. Jacqueline Duby, Eric Halperin, Lisa James, "High Cost and Hidden From View: The $10 Billion Overdraft Loan Market", Center for Responsible Lending (May 26, 2005).

exceed the amount of credit extended in overdraft loans themselves.[5] By far, the most common triggers of overdraft fees are small debit card transactions—transactions that could easily be denied at the point of sale at no cost to the consumer.

Total overdraft fees have increased due to both an increase in cost and an increase in frequency:

- *Cost.* From 1997 to 2007, the average overdraft fee charged by financial institutions increased from $16.50 to $29.[6] CRL estimates that the average fee paid by consumers is $34,[7] which is unsurprising since the sixteen largest banks charge an average fee of $35.[8] The FDIC's 2008 survey, which included many smaller financial institutions, found an average among its institutions of $27 per overdraft.[9]
- *Frequency.* As recently as 2004, 80 percent of institutions denied debit card transactions that would have overdrawn the account.[10] Today, 90 percent of the Nation's largest institutions routinely approve these transactions and charge a fee for each overdraft.[11] This shift has increased the frequency of overdrafts significantly, particularly given the overall increase in debit card use.[12]

Overdraft fees affect a very large number of consumers each year. CRL recently estimated that over 50 million Americans overdraw their accounts annually, with 27 million paying five or more overdraft or NSF fees.[13] Most of these fees are paid by a relatively small number of consumers: The FDIC found that 93 percent of all overdraft fees are paid by only 14 percent of account holders. These consumers are more likely to be lower-income, nonwhite or young account holders, who are the account holders least able to afford such fees.[14] In the midst of a recession, abusive overdraft practices are making the dire financial situations faced by many families even worse.

II. Regulators Have Failed To Stop the Abuses

The Federal Reserve Board (FRB) first requested comment on overdraft programs in 2002. Three years later, the FRB, along with the Office of the Comptroller of the Currency, the FDIC and the National Credit Union Administration, issued final Joint Guidance addressing overdraft programs. This guidance clearly recognized the problematic features of overdraft programs, but it failed to prohibit any of them. In-

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[5] Overdraft Explosion at 7 (estimating $23.7 billion in fees charged in exchange for $21.3 billion in credit extended).

[6] Comments of the Center for Responsible Lending to the Board of Governors of the Federal Reserve System, Office of Thrift Supervision, and National Credit Union Administration on Proposed Rule Regarding Unfair and Deceptive Practices—Overdraft Practices (Aug. 4, 2008), notes 62-63, and accompanying text, available at *http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/overdraft-comments-udap-final-as-submitted-w-appendices-080408-2-1.pdf* [hereinafter CRL 2008 UDAP Comments].

[7] 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/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf* [hereinafter Debit Card Danger].

[8] Consumer Federation of America, "CFA Survey: Sixteen Largest Banks Overdraft Fees and Terms" (updated July 31, 2009), available at *http://www.consumerfed.org/pdfs/overdraft_fee_report_09.pdf* [hereinafter 2009 CFA Survey].

[9] FDIC Study of Bank Overdraft Programs, p. iii of the Executive Summary, available at *http://www.fdic.gov/bank/analytical/overdraft/FDIC138_ExecutiveSummary_v508.pdf* (2008) [hereinafter FDIC 2008 Overdraft Study].

[10] Mark Fusaro, "Are 'Bounced Check Loans' Really Loans?", n. 4, at 6 (noting 20 percent of institutions in June 2004 were applying "bounce protection" to debit cards or ATM) (Feb. 2007), available at *http://personal.ecu.edu/fusarom/fusarobpintentional.pdf.*

[11] Of the Nation's 10 largest institutions (per the FDIC's June 30, 2009, listing according to total domestic deposits), only Citibank routinely denies debit card transactions rather than approving them for a fee. Moreover, while as recently as 2004 overdraft loans accounted for 60 percent of institutions' total overdraft/insufficient funds revenue, today they account for approximately 70 percent of that revenue—indicating covering overdrafts, rather than denying them, is increasingly the norm. 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/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf* [hereinafter "Out of Balance"].

[12] In 2007, the Federal Reserve reported that debit card transactions were increasing at a rate of 17.5 percent per year. 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.*

[13] Overdraft Explosion at 3.

[14] FDIC 2008 Overdraft Study, Executive Summary at IV.

stead, it described a number of "best practices," which merely encouraged institutions to avoid those problematic features.

These best practices included that institutions (1) consider limiting overdraft coverage to checks (*i.e.,* consider not extending overdraft coverage to debit card transactions) and that they (2) monitor excessive usage, which regulators stated may indicate a need for an alternative credit product.

When asked whether this guidance would be treated as law, regulators responded: "The best practices, or principles within them, are enforceable to the extent they are required by law." [15] But the regulators required none of them by law, and the guidance has largely been ignored in the years since.

Just last week, the FRB issued new overdraft rules that address whether and how intuitions are required to obtain consumers' consent to a product their Best Practices suggest shouldn't be provided at all—overdraft coverage of debit card transactions. [16] The rule will require institutions to obtain consumers' affirmative consent, or "opt-in," before charging them overdraft fees on debit card purchases and ATM withdrawals. We strongly encouraged the FRB to issue this version of its proposal, as no consumer should be automatically enrolled in any credit product, much less an abusive one.

But this measure alone is largely inadequate, as it fails to address other fundamental problems with today's fee-based overdraft programs. The FRB's rule condones charging fees for debit card overdrafts, which could easily be denied for no fee; it does not address checks and electronic payments at all; it does nothing to address the dramatic disparity between the amount of the overdraft and the amount of the fee institutions charge for covering it; and it fails to address the problem of an excessive number of overdraft fees being borne by a relatively small and vulnerable group of consumers.

In short, neither the FRB nor any other banking regulator has meaningfully addressed the full range of harm to consumers caused by abusive overdraft programs. Since regulators first recognized high-cost overdraft programs as a problem in the early 2000s, practices have only grown worse, and consumers have paid more than $100 billion in overdraft fees. This failure on the part existing regulators is a striking illustration of the need for a Consumer Financial Protection Agency.

See Appendix A for further discussion of how the regulatory agencies have failed to stem abusive overdraft practices.

III. S. 1799 Will Provide Much-Needed Reform of Overdraft Practices

Given that the Federal regulators have not prohibited abusive overdraft practices, we are very encouraged to see the Senate considering S. 1799. The bill contains provisions essential to addressing the fundamental problems with today's overdraft programs:

- A requirement that overdraft fees be reasonable and proportional to the actual cost to the institution of covering the overdraft.
- A limit of six overdraft fees per year. Once a customer has incurred six fees in a 12 month period, the institution would be required to provide a longer-term, lower cost alternative, such as a line of credit, in order to continue covering the customer's overdrafts for a charge.
- Codification of a prohibition of overdraft fees on debit card and ATM transactions unless institutions have obtained the customer's affirmative consent, or "opt-in."

These provisions correspond well with the best practices provided in the 2005 Joint Guidance addressing overdraft programs. The Guidance suggested that institutions consider making overdraft coverage unavailable for transactions other than checks; monitor excessive overdraft program usage, which may indicate a need for an alternative credit arrangement or other services; and obtain customers' affirmative consent to receiving overdraft coverage. [17]

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[15] *Id.*

[16] Federal Reserve's press release available at *http://www.federalreserve.gov/newsevents/press/bcreg/20091112a.htm.* Final rule available at *http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20091112a1.pdf.*

[17] Department of the Treasury-Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127 (Feb. 24, 2005) [hereinafter 2005 Joint Guidance].

IV. The Problems With Today's Fee-Based Overdraft Programs

Financial institutions often justify overdraft fees and the lack of relationship these fees have to cost by asserting that they are penalty fees, intended to deter future overdrafts. But in the debit card context, the institution can stop the behavior altogether by denying the transaction at the point-of-sale, at no cost to the consumer. In reality, approving debit card overdrafts facilitates rather discourages overdrafts. Since the most effective way to prevent debit card overdrafts is within the institution's control, a penalty fee is not appropriate for a debit card overdraft. Overdraft fees on checks and electronic transactions should only be allowed with baseline substantive protections.

Today's fee-based overdraft programs cause substantial injury to account holders. The cost of overdraft fees far exceeds any benefit they may provide. Moreover, the large majority of fees are paid by a relatively small number of account holders who incur numerous fees and are least able to quickly recover from them. For these account holders, one overdraft fee causes subsequent overdraft fees, driving them further into debt and ultimately making them less likely to be able to meet essential expenses. As our real-life case study detailed below demonstrates, fee-based overdraft leaves these account holders worse off than cheaper overdraft alternatives or even than no overdraft coverage at all.

An overdraft line of credit is an appropriate credit product for customers who qualify for it. If a customer does not qualify for a line of credit, however, it is certainly not appropriate to extend that customer far higher cost credit on repayment terms far more difficult to meet. Indeed, those least likely to qualify for a line of credit are those least likely to be able to shoulder high-cost overdraft fees. This high-cost credit is predatory, and it is driving responsible overdraft products out of the market.

A. The cost of overdraft fees far exceeds any benefit provided.

In the aggregate, fee-based overdraft programs cost consumers nearly $24 billion each year, which is even more than the $21.3 billion in loans extended in exchange for those fees.[18] The most common triggers of overdraft fees, which are debit card transactions, cause an average overdraft of under $17 yet trigger an average fee of $34.[19] This fee—twice the size of the loan itself—does not even provide the account holder the benefit of avoiding a denied transaction fee because the cost of a denied debit card transaction is zero.[20] Charging any overdraft fee at all on a debit card transaction is simply not justifiable because the institution typically has the ability to prevent the transaction at the point-of-sale.

In other contexts, Federal regulators have taken steps to address high fees imposed for low levels of credit. In the credit card context, for example, the FRB determined that the excessive fees associated with "fee harvester" credit cards "diminish the value of the account"; as a result, the FRB limited up front fees on these cards to 50 percent of the total credit provided and required any fees exceeding 25 percent of the credit line to be charged over a 6-month period.[21]

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

The large majority of fees are paid by overdrafters who pay large numbers of fees and are least able to recover from them. The FDIC's recent study of overdraft programs, consistent with CRL's previous research, found that account holders who overdrew their accounts five or more times per year paid 93 percent of all overdraft fees.[22] It also found that consumers living in lower-income areas bear the brunt of these fees.[23] Seniors, young adults, military families, and the unemployed are also

[18] Overdraft Explosion at 7.

[19] The avg. overdraft amount for debit card transactions is $16.46. Debit Card Danger at 25.

[20] In its Regulation E Proposal, the FRB states: "the consequence of not having overdraft services for ATM and one-time debit card transactions is to have a transaction denied with no fees assessed." 74 Fed. Reg. 5218. Currently, charging NSF fees for denied debit or ATM transactions is not a common practice. *See* Center for Responsible Lending's CRL 2008 UDAP Comments at 18-19 for discussion of why this practice should be prohibited by the FRB.

[21] 74 Fed. Reg. 5542.

[22] FDIC 2008 Overdraft Study at iv.

[23] *Id.* at v. 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 than the general population to be lower income, nonwhite, single, and renters. Respondents reporting the most overdraft incidents were those earning below $50,000/year. Leslie Parrish, Consumers Want Informed Choice on Overdraft Fees and Banking Options, CRL Research Brief (Apr. 16, 2008) (*http://www.responsiblelending.org/overdraft-loans/research-*

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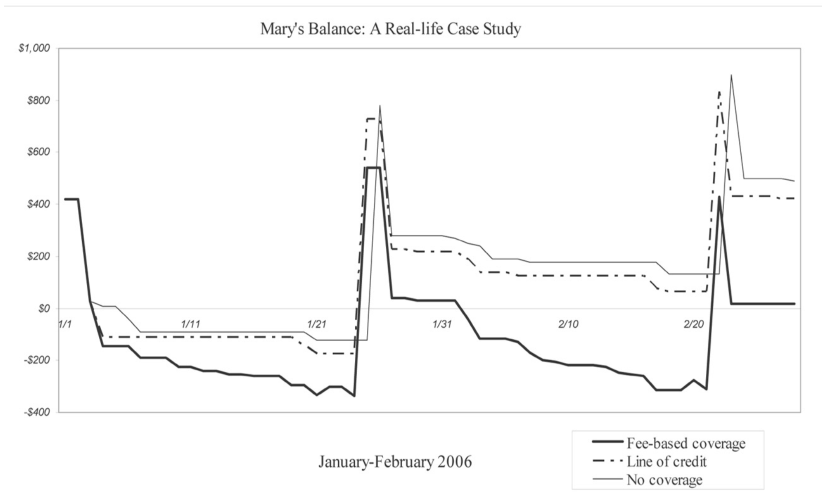
hit hard.[24] Americans aged 55 and over pay $6.2 billion in total overdraft fees annually—at least $2.5 billion for debit card/ATM transactions alone[25]—and those heavily dependent on Social Security pay $1.4 billion annually.[26]

C. Overdraft fees leave account holders worse off than lower cost coverage or even no coverage at all.

Fee-based overdrafts not only leave account holders worse off than cheaper overdraft alternatives; they even leave account holders worse than no overdraft coverage at all. For a recent report on the impact of overdraft fees on older Americans, we tracked 2 months of actual checking account activity of one panelist, whom we call Mary, from our database.[27] Mary is entirely dependent on Social Security for her income. We compared the actual activity with what her account activity would have been with an overdraft line of credit. We then added a third scenario: no fee-based coverage at all. The results are graphically demonstrated below.



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 of debt, using the bulk of her monthly income to repay costly overdraft fees. Notably, even with fee-based coverage, Mary's utility bills were denied in both January and February because overdraft fees had driven her so far into the red that the bank eventually stopped approving her transactions.

With an overdraft line of credit at 18 percent, after 2 months, Mary would have paid about $1 in total fees for her overdrafts and would have had $420 in the bank.

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.

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analysis/consumers-want-informed-choice-on-overdraft-fees-and-banking-options.html. See CRL 2008 UDAP Comments at 19-21 for further discussion.

[24] For further discussion, see Comments of the Center for Responsible Lending to Board of Governors of the Federal Reserve System on Proposed Rule to Amend Regulation E—Overdraft Practices (Mar. 30, 2009), Part II.B.1(b), pp. 10–12, available at *http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/comments-on-regulation-e-overdraft-practices.html* [hereinafter CRL 2009 Regulation E Comments].

[25] 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/overdraft-loans/research-analysis/shredded-security.html.* The report found that debit card POS and ATM transactions account for 37.4 percent and 2.5 percent respectively (p. 7), which, when calculated, together equal $2.5 billion.

[26] *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.

[27] CRL analyzed 18 months of bank account transactions, from January 2005 to June 2006, from participants in Lightspeed Research's Ultimate Consumer Panel. For further discussion of our database and methodology, see "Out of Balance" at 13-14.

She might or might not have been charged an NSF fee for each of the three denied electronic transactions. She also might 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, her ending balance still would have been $489—more than enough to cover the value of the denied transactions.

Mary's situation illustrates a problem common among the chronic overdrafters who pay the vast majority of the fees: Overdraft fees simply beget more overdraft fees. Ultimately, fee-based overdraft coverage prevents account holders from being able to meet obligations they otherwise would have been able to meet.

Said another way, fee-based coverage can lead to denial of transactions that would not have been denied but for the debt created by high-cost overdraft fees.

D. Overdraft fees are not reasonably avoidable by many consumers.

1. Account holders often lack sufficient information about their accounts. The FRB has acknowledged the difficulty of knowing one's own checking account balance, 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 credit from a returned purchase will be made available."[28] Debit holds (occurring when institutions make a portion of a customer's account balance unavailable pending settlement of the final amount of a purchase) and deposit holds (occurring when institutions delay a customer's access to deposited funds) and the lack of transparency about the order in which transactions are cleared contribute to account holders' confusion about their balances. Making matters worse, account balance disclosures sometimes include funds available for overdraft, without including warning that accessing those funds could trigger fees, potentially leading customers to unwittingly spend more money than they have.[29]

2. Economic hardship prevents those who pay the large majority of fees from reasonably avoiding them. The FRB has acknowledged in multiple contexts that broader economic hardship could prevent consumers from reasonably avoiding injury. In the context of raising interest rates on existing credit card balances, for example, the FRB cited several sources indicating that loss of income, illness, or other factors outside the consumer's control lead to delinquency.[30]

Likewise, in its discussion of ability to repay in the final HOEPA rule, the FRB identified several reasons why borrowers, especially in the subprime market, cannot necessarily avoid unsustainable loans, including that "they may . . . urgently need the cash that the loan will provide for a household emergency."[31]

In the overdraft context, there is no question that economic hardship contributes to many account holders' inability to avoid fees.[32]

3. Financial institutions engage in many practices designed to maximize overdraft revenue. The increase in overdraft fees—both the cost and the frequency—over the past several years is the result of a concerted effort on the part of many financial institutions to maximize overdraft revenue. These institutions:

- have purchased specialized software that helps them maximize fee revenue and paid consultants to help them do so;

[28] 73 Fed. Reg. 28929.

[29] *See,* 2008 Proposed Rule to amend Regulation DD, 73 Fed. Reg. 28743-44. While the FRB's final Regulation DD rule will require that the first balance displayed exclude overdraft funds available, it will allow a second balance to be displayed that includes overdraft funds available, even with no disclosure that accessing such funds will or may incur a fee. 74 Fed. Reg. 5593.

[30] 74 Fed. Reg. 5523. The FRB cites the FTC Credit Practices Rule, which found "the majority [of defaults] are not reasonably avoidable by consumers" because of factors such as loss of income or illness; Bank of America testimony noting that falling behind on an account is likely due to circumstances outside the customer's control; and an economic journal finding conclusive evidence that unemployment is critical in determining delinquency.

[31] 73 Fed. Reg. 44542.

[32] Some may posit that the injury caused by overdraft fees must be avoidable because only a relatively small portion of consumers frequently overdraw their accounts. But the FRB has already concluded that, although injury may be avoidable by some consumers under some circumstances, it may not be reasonably avoidable as a general matter. In its analysis of payment allocation methods in the credit card context, the FRB noted that "[a]lthough a consumer could avoid the injury by paying the balance in full every month, this may not be a reasonable expectation as many consumers are unable to do so." It applied a similar analysis to increasing interest rates on existing balances. The FRB acknowledged that the injury resulting from increases in the annual percentage rate "may be avoidable by some consumers under certain circumstances," but it nonetheless concluded that, "as a general matter," consumers cannot reasonably avoid interest rate increases on existing balances." 74 Fed. Reg. 5522. In both circumstances, the FRB concluded that the injury caused by these practices was not reasonably avoidable.

- have expanded their overdraft programs to debit card purchases and ATM transactions;
- often post debits as quickly as possible, while delaying for as long as possible making those deposits available for use;[33]
- manipulate the order in which they clear transactions.[34] (Institutions often clear purchases in order from highest to lowest, rather than the order in which they occurred, in order to deplete the account to below zero more quickly. Once the account balance is negative, the institution is able to charge an overdraft fee on each subsequently posted transaction, often resulting in significantly more overdraft fees.)

E. Overdraft fees harm not only consumers, but also the banking sector and the economy as whole.

Today's exploitative fee-based overdraft programs harm the banking industry and, ultimately, the economy as a whole.

Without baseline protections, institutions are engaged in a race to the bottom that provides tremendous disincentives to operating fair overdraft programs. Given the high fees that institutions generate through fee-based overdraft, institutions choosing to operate fair overdraft programs risk placing themselves at a substantial disadvantage. It's unsurprising, then, that most of the largest institutions—and many smaller institutions—have substantially similar abusive programs. (Of the largest institutions, only one—Citi—routinely denies debit card overdrafts.)

Moreover, institutions are generating a substantial portion of their revenues through overdraft practices that both regulators and legislators have deemed questionable. In the interest of safety and soundness, all would be better served if institutions generated greater portions of their revenue through practices that have not drawn such scrutiny and criticism. Instead, today's overdraft programs award banks for counterproductive programs while distracting them from core banking activities. A representative of one financial institution that implemented software designed to increase overdraft fees stated: "If I had two more products like the IMPACT Automated Overdraft Privilege, I could quit making loans altogether."[35]

Finally, taxpayers spent hundreds of billions of dollars to bail out banks while being told they would provide critical credit to the economy—not with the expectation that institutions would continue to extract revenues from those with relatively little resources. Redirecting these individuals' incomes toward productive goods and services would do far more for economic recovery than allowing practices that drive them deeper into debt.

F. Concern about denied checks does not justify maintaining the status quo.

Some have posited that limiting today's fee-based overdraft programs will create problems for consumers by leading to an increase in bounced checks. It is important to note that, as Mary's story above illustrates, plenty of checks bounce even under today's overdraft programs. In fact, checks often bounce due to the debt created by high overdraft fees themselves.

Moreover, checks account for only about a quarter of all overdraft fees.[36] The far more common triggers of overdraft fees are debit cards—transactions that carry no penalty at all when denied.

V. S. 1799 Addresses the Fundamental Problems With Today's Overdraft Programs

S. 1799 addresses three key unfair features of fee-based overdraft programs: (1) charging fees that are not reasonable or proportional to the cost to the institution of covering the overdraft; (2) charging excessive numbers of fees that create a debt trap for those paying the majority of overdraft fees; and (3) charging overdraft fees

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[33] *See,* CRL 2008 UDAP Comments at 37, Part III.B.

[34] *See,* CRL 2008 UDAP Comments at 38, Part IV. Recently, an advisor on overdraft and card strategies at Profit Technologies acknowledged that fees are a key driver of institutions' transaction clearing practices: "'Banks will say (high-to-low clearing) is for the consumer,' he says. 'Bottom line is, when it was pitched, we'd say . . . a side effect is that it results in more fee income to you because it bounces more checks.' [The advisor] says that after leaving Profit Technologies, he joined a credit-counseling firm and saw the damage fees did to consumers." Kathy Chu, "Banks' 'Courtesy' Loans at Soaring Rates Irk Consumers", *USA Today,* July 13, 2009.

[35] Statement by an unidentified client of IMPACT Financial Services, available until recently at *https://impactfinancial.com/portal/Endorsements/ClientTestimonials/tabid/70/Default.aspx* (last viewed on-line Mar. 8, 2009).

[36] Debit Card Danger at 25. CRL's research found that checks accounted for 27 percent of all overdrafts, which is likely decreasing as paper checks are decreasing generally.

on debit card and ATM transactions without obtaining a customer's affirmative consent to having overdrafts covered.

A. Addressing High Cost: Reasonable and Proportional Requirement.

S. 1799 would require that overdraft fees be reasonable and proportional to the actual cost to the institution of covering the overdraft, with the FRB providing additional guidelines for what constitutes "reasonable and proportional," potentially including a safe harbor.

As noted earlier, the average overdraft fee exceeds the amount of the overdraft covered. This disparity is particularly outrageous given the short period of time for which the typical overdraft is outstanding—three to five days [37]—and the low default risk overdrafts carry. Indeed, the only two circumstances under which an overdraft loan is not repaid are when another deposit is never made into the account or when the customer walks away from the account. Operational cost is also low because most programs are highly automated.

The recently passed CARD Act requires the FRB to promulgate standards for reasonable penalty fees and specifies that penalty fees be proportional not only to cost but also to the violation or omission. We support S. 1799's slightly different approach, which does not authorize consideration of the "violation or omission" because it is overwhelmingly clear that overdraft fees as currently administered do not deter overdrafting. [38] In fact, institutions' overdraft practices have evolved from approving the occasional overdraft as a customer courtesy to routinely approving transactions, even those they could easily deny at the point of sale for no fee. These practices encourage rather than discourage overdrafts.

In addition, the primary effect of the increase in the average overdraft fee charged over the last decade has not been deterrence; rather, it has been to increase the number of overdraft occurrences by chronic overdrafters, due in large part to the debt trap created by high fees.

The obvious way to deter overdrafts is to deny transactions that would overdraw the account—not to approve them for an exorbitant fee that only drives consumers deeper into debt and makes them more likely to overdraw their account again.

We note that while S. 1799 would exclude overdraft fees from the interest rate cap applicable to Federal credit unions, we do not support such exclusion and believe all credit extended by Federal credit unions should be subject to the interest rate cap.

B. Addressing Frequency: Annual Limit on the Number of Fees.

S. 1799 would limit the number of overdraft fees an institution may charge a customer to six per year. After six fees have been incurred, the institution could only continue covering overdrafts for a charge if the customer enrolls in a lower-cost alternative. The banking agencies have long advised institutions to discourage excessive use of overdraft programs, but this guidance has largely not been followed. [39]

This proposed limit recognizes that if a customer qualifies for a lower cost form of overdraft coverage, the institution should provide that coverage to the customer. If the customer doesn't qualify for lower cost coverage, that customer certainly is not in a position to shoulder more than six overdraft fees a year.

Banking regulators have also long discouraged practices analogous to excessive overdraft loans. [40] The repeat borrowing illustrated in our case study above is analogous both to loan flipping of other high-cost short-term loans, such as payday loans, loan flipping in the mortgage context, and pyramiding late fees:

- *Other high-cost, short-term loan flipping.* Excessive overdraft loans create a debt trap similar to that caused by other high-cost, short-term lending. CRL's recent

[37] Debit Card Danger at 25.

[38] There are two primary penalty fees charged in the credit card context today—late fees and over-the-limit fees. A reasonable late fee is not as likely as an overdraft fee to simply perpetuate the scenario it purports to deter. In the credit card context, avoiding an additional late fee requires that the customer pay only a minimum payment on time—not the entire outstanding balance, including fees. In the overdraft context, the entire loan, plus all fees, are repaid upon the customer's next deposit, typically 3 to 5 days later. Therefore, customers have more time to recover from a late fee than they do from an overdraft fee, and late fees are not as likely to beget late fees as overdraft fees are to beget overdraft fees.

Overdraft fees in the debit card context are very similar to over-the-limit fees in the credit card context in that they result from transactions the institution approves that it could easily deny for no fee. The clear way to deter the behavior in both contexts is to deny the transaction.

[39] 2005 Joint Guidance; OTS Guidance, 70 Fed. Reg. 8428 (2005).

[40] *See, e.g.,* OCC Advisory Letter on Abusive Lending Practices, AL 2000-7, July 25, 2000; FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005; FDIC Financial Institution Letters, Affordable Small-Dollar Loan Products, Final Guidelines, FIL-50-2007, June 19, 2007.

research finds that over three-fourths of payday loan volume is generated within 2 weeks of a customer's previous payday loan.[41] While technically a borrower typically closes an old payday loan and opens a new one, effectively the borrower is being flipped from one loan into another—unable to repay one loan and meet essential expenses without taking out another loan.[42] Payday loans beget payday loans, much like overdraft loans beget overdraft loans.

- *Mortgage loan flipping, which has already been identified as abusive.* The repeated extension of overdraft loans is also analogous to flipping borrowers from one mortgage loan to the next. In the mortgage context, an originator sells the borrower an unaffordable loan only to later refinance the borrower into another unsustainable loan, extracting fees and stripping home equity from the borrower in the process. Earlier this session, the House of Representatives passed H.R. 1728, which would ban this practice for mortgage loans. In the overdraft context, cash is similarly stripped from customers who are flipped.
- *Pyramiding late fees, which the FRB has prohibited as an unfair practice.* Pyramiding late fees occur when lenders apply future payments to the late fee first, making it appear future payments are delinquent even though they are, in fact, paid in full within the required time period. As a result, lenders charge additional late fees.[43] These fees provide no benefit to the consumer while driving them further into debt.[44] For customers who incur the majority of overdraft fees, they often would have had sufficient funds in their account to meet future expenses but for the excessive overdraft fees they have incurred in previous periods.

How regulators have addressed these analogous abuses informs what is appropriate in the overdraft context. In 2005, the FDIC limited excessive refinancings of payday loans by prohibiting the entities it regulates from making payday loans to anyone who has had payday loans outstanding for 3 months in any 12-month period.[45] The FDIC guidance encourages lenders to offer borrowers an alternative longer term product at that point but notes that even if such alternative is not available, "an extension of a payday loan is not appropriate under such circumstances."[46] Assuming a 14-day pay period, this standard limits the number of loans any borrower can have to six per year, alleviating the debt trap while continuing to allow loans to the occasional users. The FDIC further urges institutions to require "cooling off" or waiting periods between payday loans.[47] The limit on fees in S. 1799 is closely analogous to the FDIC's approach to limiting payday loans and would address the debt trap caused by overdraft loans in much the same way.

Similarly, the FRB has long prohibited pyramiding late fees as an unfair practice through its Credit Practices Rule,[48] and it recently reinforced its stance by prohibiting the same under TILA through its recent HOEPA final rule.[49]

C. Permitting Customers To Opt-In Is Crucial.

Consumers should be provided a meaningful choice about whether to participate in fee-based overdraft programs. Automatically enrolling a customer in the program, even if an institution allows the customer to opt-out later (often after the damage has been done), does not provide a meaningful choice.

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[41] Leslie Parrish and Uriah King, "Phantom Demand: Short-Term Due Date Generates Need for Repeat Payday Loans, Accounting for 76 Percent of Total Volume", Center for Responsible Lending (July 9, 2009), available at *http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.*

[42] The typical payday borrower pays an additional $45 in interest every 2 weeks, with effectively no reduction in principal—*i.e.,* no benefit—and ultimately pays $450 in interest on a $300 loan.

[43] 12 CFR 227.15 (Regulation AA).

[44] 16 CFR 444.

[45] FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005.

[46] *Id.*

[47] *Id.* The OCC, in its payday guidance, has noted that its guidance addressing abusive lending practices more generally should also be applied in the context of payday lending. That guidance identifies the following indicators of abusive lending: pricing and terms that far exceed the cost of making the loan; loan terms designed to make it difficult for borrowers to reduce indebtedness; and frequent and multiple refinancings. OCC Advisory Letter on Abusive Lending Practices, AL 2000-7, July 25, 2000.

[48] 12 CFR 227.15(a).

[49] The FRB noted that pyramiding late fees "give rise to charging excessive or unwarranted fees to consumers, who may not even be aware of the default or fees . . . Once consumers are in default, these practices can make it difficult for consumers to catch up." 73 Fed. Reg. 44569.

An opt-in arrangement provides the customer a moment during which he or she may evaluate the options available and affirmatively choose the one most suitable. In its proposed rulemaking, the FRB recognized the productive incentives an opt-in arrangement would offer: "[Opt-in would] provide an incentive for institutions to persuade consumers of the benefits of the overdraft service and enable the consumer to make an informed choice about the merits of the service before he or she incurs any overdraft fees." [50]

While an opt-in requirement must be coupled with other substantive protections, greater transparency will foster competition in the marketplace, resulting in better choices for consumers. Allowing no choice at all, or allowing automatic enrollment with only an opportunity to opt-out, are anticonsumer, nontransparent practices that have facilitated the race to the bottom in this area over the past several years.

While the Federal Reserve's recent action will require "opt-in" on debit card and ATM transactions, codification of the protections increases the likelihood they will endure over time. S. 1799 requires institutions to obtain consumers' opt-in to overdraft fees on debit card and ATM transactions. We support this requirement; we also support an opt-in requirement for overdraft fees on checks and electronic transfers. For a complete discussion of this issue, see our 2008 and 2009 regulatory comment letters. [51]

VI. Conclusion

We support S. 1799 for comprehensively addressing the most abusive features of today's overdraft programs. The bill would limit the high costs of these fees, would cut down on the frequency which fees are charged to those least able to shoulder them, and would require the customer's express consent to overdraft fees on debit card and ATM transactions.

Thank you again for the opportunity to testify today. I look forward to your questions.

APPENDIX A: REGULATORS FAIL TO CURB ABUSES

Regulators first identified overdraft practices as a problem as early as 2001, when the OCC noted the "complete lack of consumer protections" associated with these programs. Since then, overdraft practices have grown exponentially worse. While regulators have taken no meaningful steps to rein in abuses, Americans have paid well over $100 billion in overdraft fees. [52]

2001—OCC Interpretive Letter discusses numerous concerns about automated overdraft programs, noting "the complete lack of consumer safeguards built into the program," including a lack of limits on the number of fees charged per month; similarities between overdraft fees and other "high interest rate credit"; and the failure of banks to meet the needs of repeat overdrafters in a more economical way. [53]

2002—The FRB issues a preliminary request for comment on overdraft programs. [54]

2005—The FRB affirmatively exempts overdraft loans from the protections of the Truth in Lending Act when it chooses to address overdraft programs under the Truth in Savings Act instead. [55] Overdrafts continue to be made without consumers' explicit consent and with no cost-of-credit disclosures to allow comparisons of overdraft fees to less costly options.

2005—Regulators issue joint guidance, which reflects several of the OCC's 2001 concerns. But rather than explicitly prohibiting any of these practices as unfair and deceptive, the guidance only provides "Best Practices." When asked whether this guidance would be treated as law, regulators responded: "The best practices, or

[50] 74 Fed. Reg. 5225.

[51] CRL 2008 UDAP Comments at 25-27; CRL 2009 Regulation E Comments at 8-18.

[52] Determined as follows:

2009 $20.0B (per CRL's projection for 2009, Overdraft Explosion, through September)
2008 $23.7 (per CRL 2009 report, Overdraft Explosion)
2007 $20.6 (assumes midpoint between 2006 and 2008 figure)
2006 $17.5 (per CRL 2007 report, Out of Balance)
2005 $14.0 (assumes midpoint between 2004 and 2006 figure)
2004 $10.3 (per CRL 2005 report, High Cost and Hidden From View)

Total $106.3 B (Conservative estimate as it does not include any fees paid in 2001, 2002, or 2003)

[53] OCC Interpretive Letter #914 (August 3, 2001), available at *http://www.occ.treas.gov/interp/sep01/int914.pdf*. The OCC raised compliance issues with respect to TILA, TISA, EFTA, ECOA, and Regulation O (extensions of credit to bank insiders).

[54] 67 Fed. Reg. 72620 (2002).

[55] 70 Fed. Reg. 29582 (May 2005).

principles within them, are enforceable to the extent they are required by law."[56] But the regulators required none of them by law, and the guidance has largely been ignored in the years since.

2007—Despite its joint guidance acknowledging that overdrafts are an extension of credit, the OCC asserts in *Miller v. Bank of America* that its regulations allow banks to seize exempt benefits such as Social Security to pay overdraft loans and fees, claiming that they are not "collect[ing] a debt."

2008—Regulators issue a proposal under their authority to address unfair and deceptive practices (UDAP). The proposal covers all transaction types (checks, electronic payments, debit card and ATM) but proposes only that consumers have the right to "opt-out" of high-cost overdraft programs—not that institutions must obtain consumers' explicit consent before enrolling them. Regulators later withdraw the proposal.

2009—The FRB issues a rule addressing consent to overdraft fees on debit card and ATM transactions. Its provides no additional substantive protections, such as a limit on excessive fees or a requirement that fees be reasonable and proportional to the cost to the institution of covering the overdraft.

ONGOING—Best Practices Guidance continue to be largely ignored by institutions and the regulators alike. The OCC's Compliance Handbooks make no reference to overdraft programs at all,[57] much less to Best Practices.

[56] *Id.*

[57] There is little evidence to suggest that the OCC has instructed its examiners to even evaluate overdraft practices—much less attempted to encourage best practices. A search of the OCC's Compliance Handbook for depository services finds no reference to the guidance and a search of the OCC's "Other Consumer Protections" Compliance Handbook finds no reference to overdraft protection, or, indeed, to the FTC Act's UDAP provisions at all. Moreover, the OCC's message to its banks' customers has essentially been that the banks can do as they please. For example, the OCC's online consumer reference "HelpWithMyBank" has a FAQ on its overdraft section concerning transaction posting order (generally manipulated by banks to maximize overdraft fees) that validates the banks' own claim that they can post transactions in whatever order they please. *http://www.helpwithmybank.gov/faqs/banking_overdraft.html#drop08.* Additionally, Consumer Federation of America's 2009 survey of overdraft fees at the 16 largest banks finds that their average fee is $35, compared to $27 at FDIC-regulated institutions. 2009 CFA Survey. Eleven of the sixteen largest banks are OCC-supervised.