COMMENTS
of the
National Consumer Law Center
Consumer Federation of America
Center for Responsible Lending
Consumers Union
National Association of Consumer Advocates
Woodstock Institute

to the

Federal Reserve System
12 CFR Part 230
Docket No. R-1197
PROPOSED AMENDMENTS TO REGULATION DD

AND

Office of the Comptroller of the Currency
Docket No. 04-14

Office of Thrift Supervision
No. 2004-30

Federal Reserve System
Docket No. OP-1198

Federal Deposit Insurance Corporation

National Credit Union Administration

PROPOSED OVERDRAFT PROTECTION GUIDANCE

1. Introduction

The National Consumer Law Center ("NCLC")[1] (on behalf of its low income clients) and the Consumer Federation of America[2], submit the following comments for themselves, as well as

[1]**The National Consumer Law Center** is a nonprofit organization specializing in consumer credit issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys around the country, representing low-income and elderly individuals, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have. It is from this vantage point – many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities – that we supply these comments. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (5th ed. 2003) and *Cost of Credit: Regulation and Legal Challenges* (2nd ed. 2000), as well as bimonthly newsletters on a range of topics related to consumer credit issues and low-income consumers. These comments were co-authored by Chi Chi Wu, Margot Saunders, and Carolyn Carter, with assistance from Elizabeth Renuart, and are submitted on behalf of the Center's clients.
[2] The **Consumer Federation of America** is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education. These comments were co-authored by Jean Ann Fox, Director of Consumer Protection for CFA, and Laurie Lawlor, Legal Intern. Ms. Lawlor conducted the survey of bounce loan website advertisements included in Appendix A and discussed in Section 3.

the Center for Responsible Lending [check – need fn], Consumers Union [check][3], the National Association of Consumer Advocates,[4] and the Woodstock Institute[5] [check], regarding two separate dockets:

- The Federal Reserve Board's proposed rule to regulate bounce loans under Truth in Savings (TISA) and Regulation DD.
- The proposed Interagency Guidance on Overdraft Protection Programs issued by the Office of Comptroller of Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration and the Federal Reserve Board (herein referred to as "the banking regulators").

The Board's proposal to regulate bounce loans, or so-called "bounce protection," under Regulation DD is inadequate and unacceptable. Bounce loans are an extremely expensive and deceptive form of credit that entraps consumers into repetitious and unaffordable transactions. At a minimum, this credit should be regulated under the Truth in Lending Act (TILA). The proposed Regulation DD changes do little to address the serious and profound problems with bounce loans. The proposed Interagency Guidance is similarly limited in its protection of consumers. Neither document will benefit consumers to the extent that disclosures under TILA will.

In these comments, we provide the Board and banking regulators with updated information on bounce loan advertisements, the abuses of bounce loans, and consumer sentiment on bounce loans. We also discuss how the Board has violated TILA by exempting these credit transactions without going through the formal rulemaking process required by TILA. ***We formally request that, if the Board is considering exempting bounce loans from TILA disclosures, it do so pursuant to the formal rulemaking procedures set forth in TILA.***

These comments also reiterate the basis for the assertion that bounce loan fees are finance charges, and show how TILA disclosures and coverage will provide meaningful benefit to consumers. Finally, we discuss the consumer protections in addition to TILA coverage that are necessary to truly protect consumers from the abuses of bounce loans.

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[3] **Consumers Union,** the nonprofit publisher of Consumer Reports magazine, is an organization created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications. and noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.

[4] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[5] The **Woodstock Institute** is a Chicago-based nonprofit research organization dedicated to promoting community reinvestment, credit access, and sound financial services among lower-income and minority neighborhoods both locally and nationally. For over thirty years, Woodstock has supported legislation and regulation in the best interest of low-income consumers. Woodstock also convenes the Chicago CRA Coalition, a group of nearly 100 area organizations with an interest in promoting reinvestment in underserved communities.

We want to make clear that we are not opposed to overdraft programs *per se*. We are only opposed to bounce loans that are exorbitantly expensive, that are not accompanied by APR disclosures, that are imposed without affirmative consumer consent, that permit overdrafts through ATM and on-line debit transactions, or that are advertised to consumers as an easy source of credit.

2. Bounce Loans are Bad for Consumers

a. <u>Bounce Loans Make Bank Accounts Dangerous For Vulnerable Consumers</u>

Bounce loans are undermining efforts to bring unbanked consumers into the financial mainstream. For years, consumer advocates and the Department of Treasury have agreed that bank accounts are safer and cheaper than going to check cashers or keeping large amounts of cash at home. Given bounce loans, we can no longer make that claim with as much certainty– going to a check casher might just be cheaper and safer than risking expensive bounce loan fees, since one cannot overdraw cash.

Bounce loans are an extraordinarily expensive credit product. For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243%. If the consumer pays the overdraft bank in 14 days, which is probably more typical for a wage earner, the APR is 520%. Moreover, bounce loan fees can be triggered for overdrafts of a few dollars (especially for debit card point-of-sale overdrafts), making the APR even more astronomical. And once a consumer triggers an overdraft, it can start a chain reaction of fees as further overdrafts occur by means of checks, ATM transactions, debit card transactions, automatic payments, and other methods.

It appears bounce loans are becoming more popular with banks. According to the American Banker, nearly 3,000 banks now offer them.[6] A survey by the Woodstock Institute, which is attached at Appendix C, found that 7 of the largest banks in Chicago, which control over 50% of the market share in that city, have instituted bounce loan programs.

Bounce loans disproportionately impact a small percentage of consumers, who are likely to be low-income and vulnerable. A survey conducted on behalf of the Consumer Federation of America, discussed in Section 4, shows that 28% of consumers overdraw their accounts, and one third of them bounce at least three checks in the past year– translating into 9.3% of consumers. Other sources report similar data. A third party vendor who promotes bounce loans has said that about 15% of customers incur bounce loans.[7] A study by the Washington State Department of Financial Institutions reveals over 20% of borrowers who incur bounce loan fees are charged such fees two or more times per month.[8] According to another bounce loan vendor, 4% of bounce loan customers are responsible for 50% of loan fees.[9]

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[6] Laura K. Thompson, *Lending Rule Won't Apply to Overdrafts*, American Banker, May 28, 2004.
[7] Paul Gentile, *With Fed Electing Not to Treat Overdrafts as Loans, Door Wide Open for Continued Growth in CU Industry*, Credit Union Times, June 23, 2004 (quoting Bill Strunk of Strunk & Associates).
[8] Washington Department of Financial Institutions, *Overdraft Protection Programs* (September 19, 2003) at p. 4, available at http://www.dfi.wa.gov/Legislative%20report.pdf
[9] Alex Berenson, *Some Banks Encourage Overdrafts, Reaping Profit*, New York Times, Jan. 22, 2003.

Thus, bounce loan fees are mostly generated from a small minority of customers, who are probably the most vulnerable of consumers. These consumers are likely to use bounce loans repeatedly and become trapped in a cycle of debt. For them, bounce loans make bank accounts dangerous.

Conversely, banks often do not seek affirmative consumer assent when imposing bounce loans, and consumers are charged these expensive bounce fees without their consent or any prior warning. The shock is especially unpleasant when they unwittingly access bounce loans through ATM or debit cards, where traditionally it has not been possible or has been much harder to overdraft. A number of consumer complaints have been triggered by this aspect of bounce loans.[10]

Ultimately, the irresponsible actions of banks in adopting bounce loan programs may lead to more unbanked consumers. **Instead of discouraging overdrafts and encouraging sound financial management, these banks are now encouraging consumers to use high-cost credit.** By permitting overdrafts, not just through checks but ATMs and debit cards, these banks are creating new ways to impose exorbitant fees and create financial hardship. These banks may ultimately drive current low-income consumers away from bank accounts, either through disgust at high fees or involuntarily through the ChexSystem blacklist.

b. Bounce Loans Are Especially Abusive When Accessed by ATM and Debit Cards.

Because consumers do not incur retailer fees for declined transactions in these contexts, bounce loans on ATM and debit cards serve no other purpose except to provide exorbitantly priced payday loans or credit cards.[11] ATM transactions and many debit card transactions are on-line and real time. The availability of funds is confirmed,[12] and traditionally transactions are declined with no fee when consumers have insufficient funds in their account. Thus, the decision of a bank to program its computers to permit overdrafts when there are no funds is a deliberate and unfair act on the part of the bank to permit overdrafts where none would have occurred previously, solely for the purpose of collecting additional fees.

Financial institutions defend bounce loans by claiming they save consumers from merchant penalties, late charges, and embarrassment. These defenses are completely inapplicable to ATM and many debit transactions. With ATM cards, the transaction is to

[10] Selected consumer complaints received by our organizations are attached as Appendix E. News articles also have documented cases in which consumers complained about bounce loan fees from ATM or debit card overdrafts. Several news articles are attached in Appendix D. Card-based overdrafts were also involved in Lopez v. Washington Mutual, 302 F.3d 900, amended at, 311 F.3d 928 (9th Cir. 2002).

[11] The practice of permitting bounce loans through ATMs and debit cards appears to be quite widespread. CFA's review of bounce loan advertisements on the Internet, which is attached at Appendix A and discussed in Section 3, revealed that 46% of the institutions explicitly stated that bounce loans are available through ATM and debit card transactions. Only 10% of the institutions explicitly stated that bounce loans are not available at ATMs or debit card transactions. We do not know whether the 40% of the institutions that were silent on this issue offer bounce loans through ATMs and debit cards, but we suspect many do. The Woodstock Institute's survey of 7 large Chicago banks, which is attached at Appendix C, found all of them had instituted bounce loan programs that allowed ATM and debit card overdrafts.

[12] *See* In re Visa Check/Mastermoney Antitrust Litigation, 192 F.R.D. 68 (E.D.N.Y. 2000).

provide cash directly to the consumer – there is no merchant or other third party involved. Even one CEO of a credit union that offers bounce loans admitted that ATM cash bounce loans are abusive and that "we're talking entertainment dollars in a lot of cases."[13]

With debit cards, there are similar concerns. Like ATM withdrawals, PIN-based debit card transactions are also on-line and real-time.[14] With debit card transactions through the MasterCard or VISA networks, most merchants will check funds availability from the bank, which has the ability to inform the merchant that a transaction will overdraw the account. In that situation, allowing overdrafts instead of declining the transaction is just as much of an unfair practice as allowing them in the PIN-based context. Also, the fact that a transaction is processed through the MasterCard or VISA network gives even more support for treating debit card bounce loan transactions as "credit card" transactions (see Section 6.b below)

Because debit card transactions are at the point-of-sale, if the transaction is declined or at least the consumers warned that they are about to overdraw their account, the consumer often has the ability to undo the transaction (i.e. put the merchandise back on the shelf) or use an alternative form of payment without incurring a hefty penalty. While there is a third party involved and perhaps a chance of slight embarrassment if a transaction is declined, that risk is preferable to a hefty $20 to $35 fee.

We believe that the availability of bounce loans though ATM and debit card transactions is one reason for the tremendous growth in fee income for overdrafts, an issue that demands further research. The third party vendors who market bounce loan programs claim they can increase overdraft fee income significantly.[15] One important question is whether increased overdrafts are a result of more consumers overdrawing by check -- which is bad because it means consumers are being encouraged to write more bad checks -- or because now consumers are paying expensive overdraft fees for ATM and debit card transactions that previously were declined without a fee.

In any event, we urge the banking regulators to use their authority under the Federal Trade Commission Act to ban bounce loans through ATM and on-line debit card transactions. Furthermore, banks should be prohibited from extending bounce loans for signature-based debt cards where a merchant has checked funds availability, and the bank has the ability to decline the transaction for lack of funds. At a minimum, the banking regulators need to make **mandatory**

[13] Paul Gentile, *Overdraft Protection at the ATM is Pushing it, says CEO*, Credit Union Times, July 3, 2004, at www.cutimes.com.

[14] *See* In re Visa Check/Mastermoney Antitrust Litigation, 192 F.R.D. 68 (E.D.N.Y. 2000).

[15] For example, Pinnacle's website states that the average increase in income from overdraft fees is 80%, based on more than 300 financial institutions using the service. http://www.pinnaclefinancialstrategies.com/products/overdraft/banks/benefits.html, last visited January 24, 2004. John M. Floyd Associates claims that participating financial institutions will increase their NSF income anywhere from 50 to 300 percent. www.overdraftprivilege.com/odp.html, last visited January 24, 2004. Furthermore, these promises appear to bear out. First Commerce Bank in Corpus Christi, Texas, doubled its income from insufficient funds within a year of adopting a bounce protection plan. Laura K. Thompson, *Overdraft Play Looks Better to Small Banks*, American Banker, April 2, 2001, at 1.

their suggestion that the consumer be given an opportunity to cancel ATM and debit card transactions that will overdraw their accounts.[16]

3. Current State of Bounce Loan Advertisements

Bounce loans continue to be promoted by financial institutions, and there are still many abuses in these advertisements. The Consumer Federation of America conducted a review of the websites of 50 financial institutions to assess the current state of advertising and disclosures of this product. The results show that, despite over a year and a half of controversy surrounding this loan product,[17] and the announcement of the proposed Interagency Guidance over 2 months ago, many financial institutions continue with "business as usual" for bounce loans.[18]

CFA's review examined both advertisements and the Policy/FAQ/ fine print sections of websites (hereinafter "Policy/FAQ disclosures"). Out of 50 websites, 41 of them contain advertisements for bounce loan programs, while 23 contained Policy/FAQ disclosures. These advertisements and disclosures show that bounce loans are not simply an incidental courtesy, but a contemplated part of the formal banking relationship between the financial institution and the consumer.

Furthermore, some financial institutions continue to market bounce loans aggressively. Over one third (34%) of the advertisements contained language that encouraged customers to overdraw their accounts, using statements about "running short on cash between paydays" or "checking account running a little thin?" One advertisement even touted bounce loans as an "excellent alternative to expensive payday lending loan or check cashing outlets."

Many of the websites also made contradictory statements suggesting guaranteed coverage, using themes of "we've got you covered" or "peace of mind," while downplaying the "discretionary" aspects of the program that were disclosed. Over half (54%) of the advertisements promoted the guarantees of coverage more heavily than the discretionary nature. Such contradictions would appear to be deceptive and unfair practices under the Federal Trade Commission Act.

The review of bounce loan advertisements and Policy/FAQ disclosures also found that institutions did not provide vital information about the requirements and terms of bounce loans. These omissions are especially problematic given there is no common understanding of how these programs operate that a reasonable consumer could be expected to know. For example, only 39% of the advertisements and only about a quarter (26%) of the Policy/FAQ disclosures revealed the specific dollar amount of the bounce loan/overdraft fee. Only 39 % of both

[16] CFA's review of financial institution websites, which is attached at Appendix A and discussed in Section 3, found that none of the bounce loan advertisements or disclosures stated whether the ATM would warn consumers who were about to overdraw their accounts.
[17] Consumer Federation of America & National Consumer Law Center, Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks (Jan. 27, 2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml.
[18] A summary of CFA's survey and copies of the website advertisements are included as Appendix A to these comments.

advertisements and disclosures informed the customer about the expected repayment schedule for bounce loans.

4. CFA Survey Poll on Overdrafts

Recently, a survey poll of a representative sample of 1,000 adult Americans conducted for CFA by Opinion Research Corporation International asked consumers their opinion about two features of bounce loans. The survey asked consumers about their opinions on the fairness of: 1) the fact that banks permit overdrafts without obtaining the consumer's affirmative consent; and 2) the fact that banks that permit customers to overdraw their accounts at automatic teller machines (ATMs) without providing the consumer with any notice or warning of the overdraft on the ATM screen or asking for consent to advance funds and impose a fee.[19]

Well over twice as many consumers thought that banks permitting overdrafts without obtaining the consent of their customers was unfair (68%) rather than fair (29%). On the question of permitting overdrafts without any notice at the ATM, an overwhelming majority (82%) said that this practice was unfair, with 63% saying it was "very unfair." Only 17% said it was fair.

The survey poll also asked consumers about their own experiences with overdrafts. These results show it is important for the Board to consider the impact of bank overdraft policies on consumers who are most likely to overdraw their accounts and trigger overdraft fees. The survey found that 28% of consumers said they had bounced at least one check in the past year. Of these consumers, about two-thirds said they had bounced only one or two checks, while the remaining one-third said they had bounced at least three checks. In surveys, consumers typically underreport the frequency with which they bounce checks.

Most critically, the survey obtained information about who was most likely to have overdrawn their bank accounts. The CFA survey revealed that moderate income consumers with household incomes of $25,000 to $50,000 (37%), those 25 to 44 years of age (36%), and African Americans (45%) were most likely to have done so. Twenty two percent of the lowest income group surveyed, making less than $25,000 a year, and less educated consumers (33%) reported that they do not have a bank account.

5. The Board Violated TILA by Not Going Through Exemption Procedures of TILA

We cannot understand how the Board can explicitly admit that bounce loans are credit, then fail to regulate them under the key federal law governing credit disclosures.[20] Moreover, the Board has exempted this category of credit from TILA disclosures without doing going through the formal exemption process set forth in TILA. In doing so, the Board has violated TILA.

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[19] A list of the questions used in survey poll is included in Appendix B.

[20] The New York Times expressed a similar sentiment in an editorial opinion. Untruth in Lending, New York Times, June 12, 12004. Articles about the Board's proposal to regulate bounce loans under Reg. DD are attached in Appendix D.

a. Bounce Loans Are Credit And The Banks That Offer Them Are Creditors

Bounce loans clearly fit under TILA's definition of credit as "the right granted by a creditor to a debtor to defer payment of a debt or to incur debt and defer its payment."[21] Previously, the Office of Comptroller of Currency had recognized that bounce loans are credit as defined by TILA, as had several state regulators.[22] And despite refusing to require TILA disclosures, the Board acknowledges that bounce loans are credit in the supplemental information for the proposed rule.[23]

In addition, the proposed Interagency Guidance by the banking regulators, *which includes the Board*, clearly and explicitly refers to bounce loans as credit at several points:

- In the "Safety & Soundness Considerations" section, the Guidance states "[o]verdraft balances should be reported as loans" in Call Reports and should be "risk-weighted according to the obligor."[24]
- In the "Truth in Lending Act" section, the Guidance states "[w]hen overdrafts are paid, credit is extended."[25]
- In the Equal Credit Opportunity Act section, the Guidance states that the ECOA's prohibitions against discrimination for credit transactions apply to bounce loan programs.[26]

Financial institutions that extend bounce loans are also "creditors" under TILA, because they regularly extend consumer credit subject to a finance charge or payable in over four installments, and the bounce loan obligation is payable to them. One can assume these same banks make dozens if not hundreds of other types of loans that carry a finance charge or are payable in many installments, such as mortgages, credit card accounts, or automobile loans. The Commentary to Regulation Z specifically states that once a person meets one of the numerical tests to be a creditor, that person is a creditor for other types of credit.[27]

b. The Board May Only Exempt Bounce Loans from TILA Pursuant to the Statutory Process

[21] 15 U.S.C. § 1602(e).
[22] Daniel P. Stipano, Deputy Chief Counsel, Office of Comptroller of Currency, Interpretive Letter No. 914 (Sept. 2001), available at www.occ.treas.gov/interp/sep01/intsep01.htm; Indiana Department of Financial Institutions, Newsletter--Winter 2002 Ed. (Nov. 2002), at 2; Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law, Consumer Credit Unit, Mar. 21, 2001. Note that overdrafts are defined as "credit" under Regulation O, which governs loans to bank insiders. 12 C.F.R. § 215.3(a)(2).
[23] The Board notes concerns that "the overall cost of obtaining *credit* through an overdraft services is not clearly presented to consumers." 69 Fed. Reg. 31760, 31762 (June 7, 2004) (emphasis added). Furthermore, the Board confirms that bounce loans are credit by stating that the Board is not proposing to cover the product at this time, but may consider TILA coverage in the future. Id. at 31,761. The Board could not claim it has the ability to cover bounce loans in the future if it did not believe the product was credit
[24] 69 Fed. Reg. 31585, 31861 (June 7, 2004).
[25] Id at 31862.
[26] Id.
[27] Official Staff Commentary, 12 C.F.R. § 226.2(a)(17)(i)-6.

Congress has not provided complete discretion to the Board to exempt products or transactions from TILA's protections. Congress has been very explicit about the analysis that the Board must engage in before transactions can be permitted to evade coverage under TILA. The Board can only provide exceptions from coverage under Section 105(a) or an exemption from coverage under Section 105(f).

Once the Board raised the question of whether bounce loans should be covered by TILA -- as it did in December 2002 -- the Board brings to bear the strictures of the TILA requirements. Congress has permitted the Board to allow creditors to *not* provide TILA disclosures either as the result of the Board's "classification, differentiations, or other provisions" under its general regulatory authority set out in Section 105(a), or pursuant to its exemption authority in Section 105(f). The Board has failed to follow either of these procedures in its analysis of whether to allow bounce loans to avoid coverage under TILA. **We specifically request that the Board follow either the process set out in Section 105(a) or in Section 105(f) to determine whether bounce loans can avoid coverage under TILA**.

i. There Has Been No "Regulatory Process" Pursuant to Section 105(a).

Under Section 105(a) the Board is only permitted to allow a "class of transactions" to avoid regulation, as the result of a regulatory process in which it determines that the "adjustment and exceptions" are "necessary or proper to effectuate the purposes of this title, to prevent circumvention or evasion thereof, or to facilitate compliance therewith."[28] The Board has not followed this avenue, as there has been no regulatory process in which the Board has engaged in this analysis. The Board's previously issued regulation allowing fees charged for payment of overdrawn checks to avoid coverage under TILA in no way satisfies this regulatory requirement. The incidental practice of some banks to cover some checks as a courtesy to selected customers is a different animal altogether from the new, tremendously profitable business model of providing bounce loans as a major mechanism of income for the institution. If there were not significant and important differences between the two, what prompted the Board to raise the question of whether bounce loans should be covered under TILA?

If the Board were to analyze, in a regulatory proceeding, the question of whether the class of transactions known as bounce loans should be excluded from TILA coverage, the statute requires that this analysis be governed by the purposes of TILA.[29] The relevant purposes of TILA are set out in Section 102(a):

> ...It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit ....

Given the competing sources of short term credit available to consumers in the marketplace of this decade, and the widely differing costs associated with these different

[28] "(a)...these regulations may contain such classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for any class of transactions, as in the judgment of the Board are necessary or proper to effectuate the purposes of this title . . .." Section 105(a); 15 U.S.C. § 1604(a).
[29] Id.

products, it is hard to imagine that a comprehensive answer to this question would allow for the wholesale exception of one product from coverage. A consumer facing a short term financial crunch has finance company loans, credit cards, traditional overdraft lines of credit, pawnshops, payday loans, and other forms of borrowing from which to choose. All of those other forms of credit are required to provide cost information as mandated by TILA. It seems inconceivable that the Board could find that the "purposes of" TILA would be "effectuated" by not covering bounce loans.

ii. There has been no regulatory process pursuant to section 105(f).

Rather than providing an exception to coverage pursuant to a regulatory process -- as required by Section 105(a) -- the Board could exempt the product from coverage pursuant to Section 105(f).[30] However, the Board has clearly not followed the requirement of that section either. Congress added a very detailed process in 1996 for the Board to follow before a class of transaction can be exempted from coverage under TILA. First, the Board must find that:

> coverage under all or part of this title does not provide a meaningful benefit to consumers in the form of useful information or protection.[31]

Second, the Board must evaluate a series of factors to determine whether the exemption is proper. The ultimate test for the exemption is clearly set out:

> (E) whether the goal of consumer protection would be undermined by such an exemption.[32]

Finally, the Board cannot engage in this analysis behind closed doors. The Board is required to consider all of the factors and publish its rationale at the time the proposed exemption is published for comment.[33] The Board has not followed this procedure in any regard, thus making the exemption for bounce loans from coverage under TILA entirely illegal.

6. TILA Disclosures Should Be Required For Bounce Loans

As discussed above, bounce loans clearly constitute “credit” and the banks that offer them are “creditors.” Thus, the key issue is whether bounce loan fees are “finance charges” under TILA.

a. <u>Bounce Loan Fees Should Be Considered Finance Charges Under TILA</u>

The plain language of TILA requires that bounce loan fees be considered a "finance charge." TILA defines a "finance charge" as "any charge payable directly or indirectly by the

[30] The Board was not required to engage in this same analysis when it previously exempted fees charged for paying overdrawn checks, as Section 105(f) was added by Congress in 1996.
[31] Section 105(f)(1); 15 U.S.C. § 1604(f)(1).
[32] Section 105(f)(2)(E); 15 U.S.C. § 1604(f)(2)(E).
[33] Section 105(f)(2); 15 U.S.C. § 1604(f)(2).

consumer, and imposed by the creditor as an incident to the extension of credit."[34] Bounce loan fees meet each element of this definition. They are payable by the consumer, imposed by the creditor, and incident to the extension of credit.

Banks have attempted to squeeze bounce loan fees into a couple of current exceptions in Regulation Z for finance charges. One provision banks have used is section 226.4(c)(3), which states that overdraft fees are finance charges if "the payment of such items and the imposition of the charge were previously agreed upon in writing."[35] However, this section actually should weigh in favor of bounce loan fees being treated as finance charges, because when banks pay overdrafts, they often do so pursuant to an agreement in writing. Banks often explicitly agree in their promotional materials that it will pay overdrafts up to a certain amount, making representations such as “we’ve got you covered” or “have peace of mind.”

Regulation Z's requirement that the banks agree in writing to pay overdrafts does not necessarily mean that such agreement needs to be part of a formal contract. A bank can agree in writing to pay overdrafts by representing that it will do so in advertisements or correspondence. Furthermore, “agreed in writing” does not mean the consumer has to affirmatively assent - consumers are often held accountable as contracting for fees that banks unilaterally impose without affirmative assent.[36]

As the Board acknowledges in the Supplemental Information to the proposed Reg. DD changes, it intended that section 226.4(c)(3) exempt overdraft fees from finance charge treatment only for the traditional situation in which a bank, on an ad hoc and occasional basis, covers a consumer's inadvertent bounced check as a customer courtesy.[37] Thus, fees for a program in which a bank systemically extends credit and charges fees for this credit should be considered finance charges. It is the systematic nature of bounce loan programs that requires that its fees be considered finance charges.

The other provisions that the banks use as a loophole is Staff Commentary section 226.4(b)(2)-1, which states: “If a charge for an account with a credit feature does not exceed the charge for an account without a credit feature, the charge is not a finance charge under section 226.4(b)(2).” The section then provides the following example.

> ii. A $5 service charge is imposed for each item that results in an overdraft on an account with an overdraft line of credit, while a $25 service charge is imposed for paying or returning each item on a similar account without a credit feature; the $5 charge is not a finance charge.

[34] 15 U.S.C. § 1605(a).
[35] 12 C.F.R. § 226.4(c)(3).
[36] See also Comments of Neil Milner, President and CEO, Conference of State Bank Supervisors, to the Federal Reserve Board re: Docket No. R-1136 - Official Staff Commentary to Regulation Z; Treatment of “Bounce Protection,” (January 27, 2003) (“...if the consumer has reason to assume, based on information received from the bank, that an overdraft will be paid (and indeed that is the bank's general practice), there exists an agreement or contract between the two parties...)
[37] 69 Fed. Reg. at 31,761.

There are two flaws with this example. The first flaw is that the example assumes that the second account which permits overdrawn items to be paid (or returned) can be a "similar account without a credit feature." As discussed in Section 5 above, overdrafts are a form of credit. Thus any account that permits overdrafts cannot fit into the category of "an account without a credit feature."

Second, the example equates the fee for an overdraft to a charge for a returned check. Historically banks have claimed that when they are paying an overdraft, they are charging the "same" fee as an NSF fee for a returned check. This is a tenuous claim at best for traditional courtesy overdrafts, because one act involves credit (an overdraft) and one does not (declining to pay a check). More importantly, this claim should be entirely rejected with respect to bounce loans. With traditional courtesy overdrafts, the overdraft fee is still meant to be a penalty to discourage overdrawing an account, and therein lies some similarity. With bounce loan fees, the fee is no longer a penalty, because the bank has encouraged the overdraft in order to reap the fee amount, and the fee is a totally different creature than a penalty NSF fee.

In short, this Commentary provision is being exploited by banks to operate a highly profitable short-term credit product without giving consumer any sense of how expensive this credit is. This is a theory that an increasing number of banks (and potentially non-bank entities) will be sure to exploit, encouraging more and more banks to offer bounce loans in higher and higher amounts and even developing other abusive credit products tied to deposit accounts.

Furthermore, this Commentary section simply should not apply when it comes to the per day fee that some bounce loan plans charge. A consumer pays a single NSF fee for a returned check but does not pay per day charges. State banking regulators have noted that these daily fees are finance charges under state law.[38] Even a third party vendor who promotes bounce protection has conceded that per day fees are finance charges and has warned against imposing them.[39] The Woodstock Institute survey, attached at Appendix C, found that 4 of 7 large banks in Chicago that have bounce loan programs also charge a per day or other periodic fee; all of these banks are *already* in violation of TILA for not providing APR disclosures and the banking regulators should be taking enforcement action against them.

Finally, this Commentary section is completely inapplicable to bounce loan fees for non-check methods of access, such as access through ATM and debit cards. In those cases, when an item is declined for payment, there is no such thing as an NSF fee and thus no comparable charge from an account without a credit feature.

b. <u>TILA Issues For ATM and Debit Cards</u>

[38] For example, the Alabama Banking Department advised banks that charging a $2 daily fee on overdrawn accounts is considered a finance charge under Alabama law. V. Lynne Windham, Associate Counsel, Alabama State Banking Department, letter to redacted company, August 14, 2001, on file with authors. <u>See also</u> Iowa Consumer Credit Code Administrator, Informal Advisory # 88, *Per Diem Charge on Honored NSF Checks As A Finance Charge Under the ICCC and Iowa Common Law*, issued August 12, 1999, on file with the authors.

[39] Alex Sheshunoff, *A New Approach to Covering Overdrafts*, Bank Director, April 1, 2002 at 56.

ATM and debit cards that access bounce loans render those cards into a form of credit card. These cards fit within the definition of a credit card under TILA, in that they are a "card … existing for the purpose of obtaining money, property, labor, or services on credit."[40] The Commentary specifically states that a card that accesses an overdraft line of credit is a credit card.[41] Furthermore, the Commentary excludes from the definition of credit card a "debit card with no credit feature or agreement, even if the creditor *occasionally* honors an *inadvertent* overdraft."[42] This exclusion implies that a debit card IS a credit card if the creditor honors overdrafts on more than an occasional basis or the overdrafts are not inadvertent - both of which are true in the case of bounce loans.

Furthermore, while there is a strong argument as discussed above that bounce loan charges for ATM and debit card transactions are finance charges, credit cards are covered under TILA whether or not there is a finance charge or credit is repayable in more than four installments.[43] In fact, TILA even has a special term for credit cards without a finance charge – "charge cards."[44] Thus, even if bounce fees were not finance charges, ATM and debit cards that access bounce loans are charge cards. The banks who offer bounce loans through ATM and debit cards are "card issuers" under TILA, and card issuers are "creditors" under TILA whether or not there is a finance charge or the credit is payable in more than four installments.[45]

c. <u>Requiring TILA Disclosures For Bounce Loans Would Not Be Burdensome</u>

As we have stated before, bounce loans should be treated as open-end credit under TILA.[46] Treating bounce protection as open-end credit avoids the logistical difficulties of closed-end disclosures for bounce loans that would make them near impossible. With open-end disclosures, the banks need only inform consumers of the existence of bounce loan fees. The really critical disclosure would be provided after the consumer is extended credit under the bounce loan plan. At that point, in the next periodic statement, the consumer would receive a single, very critical, and very easy to provide piece of information – the historical or actual APR of the bounce transaction, as calculated using the methodology in Regulation Z.[47]

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[40] TILA, 15 U.S.C. § 1602(k). They are also under Regulation Z a "card … that may be used time to time to obtain credit." 12 C.F.R. § 226.2(a)(15).
[41] Official Staff Commentary, 12 C.F.R. § 226.2(a)(15) -2.i.A. It also includes as an example a card that accesses both a credit and an asset account, i.e., a debit-credit card. Official Staff Commentary, 12 C.F.R. § 226.2(a)(15) -2.i.B.
[42] Official Staff Commentary,12 C.F.R. § 226. 2(a)(15) -2.ii.A (emphasis added).
[43] Reg. Z, 12 C.F.R. § 226.1(c)(2).
[44] Reg. Z, 12 C.F.R. § 226.2(15).
[45] Reg. Z, 12 C.F.R. § 226.2(17)(iii); Official Staff Commentary § 226.2(a)(17)(iii)-1.
[46] National Consumer Law Center, et al, Supplemental Comments to the Federal Reserve Board's Solicitation for Comments on Bounce Protection Products, Docket No. R-1136, April 28, 2003, available at www.consumerlaw.org.
[47] 12 C.F.R. § 226.14(c)(2), (3). To compensate for the reduced information prior to the first transaction, however, the Board should require additional disclosures for bounce loans. In our Supplemental Comments filed on April 28, 2003, we suggested requiring sample APRs for bounce loans in the initial disclosure, so that consumers have meaningful disclosure of the true cost of credit for these astronomically expensive products. National Consumer Law Center, et al, Supplemental Comments to the Federal Reserve Board's Solicitation for Comments on Bounce Protection Products, Docket No. R-1136, April 28, 2003, available at www.consumerlaw.org.

This single piece of information – the actual or historical APR – is fairly simply to calculate, and would only take one line of space. It would impose very little burden on banks to include this information on the monthly periodic statements that they are already required to send under Regulation E. Indeed, our contention that TILA disclosures are not overly burdensome can be shown by the fact that one major bank already offers a bounce loan program that appears to both require consumer affirmative assent and TILA disclosures. [48]

Furthermore, unfortunately, we do not think requiring banks to provide the actual APR for a bounce loan transaction will put an end to the product; requiring APRs certainly did not put an end to payday loans or refund anticipation loans.[49] What it will do is allow consumers to make an informed decision about whether to use bounce loans again.

7. TILA Coverage Will Benefit Consumers

The Board seems to believe that providing TILA coverage for bounce loans will not benefit consumers. We respectfully disagree – there are a number of reasons why consumers will benefit from both disclosures and the substantive provisions in TILA. Furthermore, TILA coverage will guarantee that consumers can actually enforce their rights, since TILA has a private right of action, unlike TISA.

a. Disclosure Of An APR Will Benefit Consumers

One of the key purposes of the Truth in Lending Act is to strengthen "competition among the various financial institutions and other firms engaged in the extension of consumer credit." [50] The fundamental premise of the Truth in Lending Act is that providing uniform disclosures will enable consumers to comparison-shop for credit, resulting in downward pressure on rates.

An APR disclosure is critical for bounce loans. Without it, consumers have no way to compare the cost of other similar credit transactions, such as payday loans, pawnbroker loans, auto title loans, overdraft lines of credit, and credit card cash advances. Under the Board proposal, the disclosed APR for a typical payday loan is 391% to 443%[51] but for a bounce loan 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.

Contrary to the Board's suggestion, consumers do find APR disclosures useful. Several studies have found that an ever increasing number of consumers know about and rely upon APR disclosures. The percentage of consumers aware of APRs increased from 27% in 1968 to over

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[48] Wells Fargo has a Direct Deposit Advance product that appears essentially to be a bounce loan which provides TILA disclosures, at least as far as can be discerned from its website. www.wellsfargo.com/per/checking/dda/index.jhtml.

[49] Requiring APR disclosures, however, might dampen enthusiasm for these products, for which at least one credit union trade publication has openly admitted its concern, stating "[t]o subject overdraft protection programs to Truth-In-Lending would require credit unions and banks to disclose the annual percentage rate, which could discourage consumers from using them." *Fed Won't Regulate Bounce Protection*, Credit Union Journal, June 14, 2004, at 12.

[50] 15 U.S.C. § 1601(a).

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

80% in 2001.[52] The percentage of consumers that read TIL disclosures carefully increased from 27% in 1977 to nearly 50% in 2001.[53] Moreover, 60% of consumers surveyed in 2001 agreed that TILA disclosures are helpful.[54] Over two thirds of consumers think that the APR is an important item of information about credit terms.[55]

Abandoning the principles of TILA is particularly ill-advised in the case of bounce loans. If a loan product carries a low APR, such as 3%, consumers will not be significantly harmed by entering into a loan transaction unaware of the APR. Bounce loans, however, carry effective APRs in the triple digits. The Board's failure to require TIL disclosures for bounce loans means that consumers are likely to enter into these abusive, extraordinarily expensive transactions while unaware of their costs.

Further, by allowing bounce loans to be made without APR disclosures, the Board misses an opportunity to increase rate competition in the segment of the consumer credit market where it is most desperately needed - the market for subprime small loans. The entry of bounce loan lenders into this market has the potential of creating more rate competition and placing downward pressure on the exorbitant rates consumers pay. However, if banks are allowed to offer bounce loan credit without making the disclosures that other lenders must make, consumers are deprived of the ability to compare bounce loans to other products. Without even-handed regulation of banks and other small loan lenders, the opportunity to enhance competition will be lost. Refusing to require APR disclosures for bounce loans means abandoning low-income consumers to the worst elements of the consumer credit market.

b. Substantive Protections Of TILA's Credit Card Provisions Will Benefit Consumers

There is another reason why consumers will benefit from TILA coverage, at least for bounce loans accessed through ATM and debit cards. Application of TILA's substantive restrictions on credit cards will go a long way in addressing one of worst aspects of bounce loans – that consumers are extended these loans without their affirmative assent, and sometimes even without their knowledge that this product is attached to their accounts.

TILA's special credit card provisions include: (i) a prohibition against the unsolicited issuance of credit cards[56] and (ii) a prohibition against set-off of a deposit account unless the consumer affirmatively consents separately in writing to either a security interest taken in the

[52] Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, Fed. Res. Bull. 201, 207 (Apr. 2002).
[53] *Id.* at 208 (Table 9).
[54] *Id*.
[55] *Id*. at 203.
[56] TILA, 15 U.S.C. § 1642; Regulation Z, 12 C.F.R. § 226.12(a); Official Staff Commentary § 226.12(a)(1)-2 (addition of overdraft privileges on a checking account with a check guarantee card constitutes issuance of a credit card). It is true that Regulation E governs issuance of an access device that permits overdraft credit extensions; however that provision applies when there is a *preexisting agreement* between a consumer and a financial institution to pay overdrafts. Reg. E, 12 C.F.R. 205.12(a)(ii). If the Board allows bounce loan fees to be exempted from finance charge treatment, it is essentially stating there is no pre-existing agreement. In that case, Regulation Z would govern issuance.

account or to an automatic payment plan.[57] These special credit card provisions apply whether or not a finance charge is imposed.

Since banks often do not obtain affirmative consent from consumers before applying bounce loans to their accounts, there is no way they could be either issuing credit cards in response to the consumer's request or getting specific separate and affirmative consent to offset deposit accounts. Thus, application of special credit prohibitions should force banks to obtain knowing and affirmative consent from consumers before the banks can apply bounce loan products to ATM and debit cards. This is one area where TILA coverage clearly and specifically addresses a key problem with bounce loans.

c. TILA Coverage Removes The Incentive To Provide Bounce Loans As A Discretionary "Service"

TILA coverage would also remove the incentive for one of the other abusive features of bounce loans, discussed in Section Two – the fact that some bounce loan advertisements lead consumers to believe they can rely on the product, but the banks' fine print disclosures claim the product is "discretionary." With the "discretionary" caveats, consumers are left without a firm commitment about the availability a product they may be relying on. Consumers may be lulled into a false sense of security to write checks against insufficient funds, only to find the bank has hung them out to dry by declining the check – a potential crime in some states.

Of course, banks use the "discretionary" language in order to exploit the provisions of Regulation Z, § 226.4(c)(3). By making clear that bounce loans are covered by TILA and bounce loan fees are finance charges, banks would no longer have the need to use the "discretionary" fine print and could make firm commitments to cover overdrafts that the consumer could rely upon.

8. Banking Regulators Need to Prohibit Other Abuses of Bounce Loans

The proposed Interagency Guidance issued by the federal banking regulators does not go far enough in protecting consumers from the harms of bounce loans. It has a few suggestions in the best practices section that may actually benefit consumers, but since they are best practices, they will not be mandatory or enforceable. The banking regulators must implement stronger protections for consumers, and those protections must be legally enforceable by both regulators and the consumers who are harmed by bounce loans.

In particular, stronger protections are required to prohibit bank advertisements for bounce loans that encourage consumers to use overdrafts for their credit needs. The banking regulators must mandate that positive consumer opt-in is required for bounce loans, as for any form of credit. No one should have credit imposed on them without their consent. The banking regulators must also ban bounce loans from ATM and debit card transactions, which are nothing more than payday loans and high-priced credit card transactions.

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[57] TILA, 15 U.S.C. § 1666h, Regulation Z, 12 C.F.R. § 226.12(d); Official Staff Commentary § 226.12(d)(1)-3 (specifically applying rule against offsets to overdraft credit).

More detailed discussion on the proposed Interagency Guidance is included in the comments by the Center for Responsible Lending, whose comments we support.

9. Conclusion

While we appreciate the Board's and other banking regulators' efforts to address bounce loans, they are simply not enough. Consumers need real protections against the abuses of bounce loans. TILA disclosures and coverage are a necessary minimum in that effort. The banking regulators also need to institute additional, enforceable consumer protections. Banks should be required to make the same disclosures and obtain the same affirmative consent that payday lenders, pawnshops, and finance companies do.