July 29, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Ave., N.W.
Washington, DC 20551

Re: **Docket No. R-1197; Docket No. OP-1198**
Interagency Guidance on Overdraft Protection Programs

Dear Ms. Johnson:

I am writing from Woodstock Institute in Chicago to comment on the interagency guidance on overdraft protection programs. Woodstock Institute is a Chicago-based nonprofit organization dedicated to promoting community reinvestment, credit access, and sound financial services to 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.

We commend the Federal Reserve Board, along with the four other federal regulatory bodies, for addressing the issue of bounced check loans. We agree that many aspects of the marketing, implementation, and disclosure of these programs are of concern to consumers at large.

However, the proposed guidance will not protect consumers from a risky "service" that effectively amounts to a short-term, high-rate loan program akin to payday lending. The banking industry insists that bounced check loans are a helpful feature that consumers demand and benefit from. This claim ignores, however, the high levels of fee income that banks collect from unsuspecting consumers, many of whom are unaware they are enrolled in a bounced check loan program. Furthermore, the ills of bounced check loans disproportionately affect low-income people, the very groups community organizations are working to bring into the banking mainstream. Current bounced check loan programs lower the quality of bank retail accounts, this reducing their advantage to consumers over check cashing stores.

We believe stronger regulation is needed on bounced check loans, and we sense the issue is a more serious concern to consumers than the Federal Reserve Board suspects. Following are some of our detailed concerns, but our main conclusion is that bounced check loans ought to be regulated under the Truth in Lending Act (TILA) rather than the Truth in Saving Act (TISA). TILA coverage would require that banks disclose the Annual Percentage Rate (APR), solicit the affirmative assent of the consumer before enrolling them in a bounced check loan product, and ensures private right of action.

Marketing. The advertising materials of banks seemingly encourage customers to behave irresponsibly; these institutions promote the program as if it were a line of credit, rather than a last-ditch attempt to avoid a negative balance. No longer does the word "overdraft" connote harmfulness; in fact, several banks nationwide engage in deceptive marketing to play down the effects of an overdraft. Says one advertisement: "Have you ever had unplanned expenses between paydays? There is no need to worry! With First Federal's Powerdraft Plan, you will be covered without the embarrassment of a returned check." Another pitches: "Access your paycheck before you have it!" Yet another states: "Overdraft Protection: Did that last check catch you off-guard? Don't worry, we've got you covered." These advertisements contradict the industry's claim that the bounced check loans are "discretionary," a claim made to escape TILA regulation.

A survey performed by the Consumers' Federation of America provides a more comprehensive analysis of banks' misleading advertisements (complete results are discussed in their separate letter). Their findings show that 34 percent of the sample advertisements contained language that encouraged customers to overdraw their accounts. Additionally, 54 percent concentrated their efforts on the guarantees of coverage more heavily than the discretionary nature of the product.

Implementation. We have found that most banks offering bounced check loans engage in questionable practices that will raise the likelihood and frequency of costly overdrafts. First, recent versions of bank software are designed to cash a customer's largest checks first, which increases the number of subsequent overdraft fees from smaller checks and transactions. Second, many banks now display a "cash available" figure rather than an "account balance" at ATM terminals and on monthly statements. In actuality, the "cash available" figure is the sum of the account balance and the overdraft limit, which misleads the customer into supposing (s)he has more money in the account. Third, no data exist to show that banks are eliminating the program from repeat users. Banks are taking a serious financial risk by extending a type of credit to all accountholders without performing credit scores or any form of underwriting.

Woodstock Institute performed a survey to better illustrate how bounced check loans are implemented. We analyzed the checking account guides of the top seven banks (by amounts of deposits) in the Chicago MSA, which together constitute 51.00 percent of the market. The following table shows our results.

All seven banks in the sample share characteristics that we deem abusive. First, the banks misleadingly submit that the service is discretionary on their part. Second, all seven banks enroll new accounts in the program automatically unless another overdraft service is initiated, such as a linked account or an overdraft line of credit. This makes it likely that many customers are not aware they have a bounced check product. Third, all seven banks also apply bounce protection programs to their ATM cards, debit cards, and POS transactions. These applications increase the likelihood that a consumer will accidentally overdraw; especially with a debit card, this can quickly set off a deluge of unanticipated

Table 1: Top Chicago banks by Market Share, June 2003, and Bounced Loan Product Characteristics

Bank	Chicago MSA Market Share of Deposits*	How much is the fee (per item)?	How is the bounced loan product initiated?	Is the service applicable to ATM, POS, and internet transactions?	Is there a sustained overdraft fee?
Bank One, NA	20.01%	$30	automatic	yes	$5 for each business day, beginning with the sixth consecutive business day the account balance is below zero.
LaSalle Bank, NA	12.13%	$28	automatic	yes	no
Harris Trust & Savings Bank	5.09%	$27	automatic	yes	$5 "consecutive day overdraft fee"
Citibank FSB	4.03%	$30	automatic	yes	no
Northern Trust Co.	3.95%	$25	automatic	yes	no
Fifth Third Bank	2.90%	$30	automatic	yes	$6 "daily overdraft fee"
Charter One Bank, NA	2.89%	$33	automatic	yes	When the account remains overdrawn for five consecutive banking days, the fee is assessed on the sixth day and then every four banking days thereafter as long as the account remains overdrawn.
	51.00% Total	Mean = $29			

*** Source: FDIC**

fees. The survey also revealed how costly a bounced check loan can be. Overdraft/NSF fees ranged from $25 to $33, with a mean of $29. In addition, four of the seven banks implement some form of an extended fee; this usually takes the form of a $5-6 daily fee for every day the account is overdrawn.

Table 2 below illustrates how costly a bounced check loan would be at each bank in the sample. Suppose a consumer, starting with an account balance of $0, made five debits of $40 each over a period of 14 days. In each case, the consumer borrowed $200 over 14 days. Following are the fees, including sustained overdraft fees per each bank's check account guide, and the effective interest rate at each of the banks:

Table 2: Bounced Check Loan Scenario

Bank	Single Overdraft/ NSF Fee	Total Overdraft/ NSF Fees for all 5 debits	Total Sustained Overdraft Fees	Total, All Fees	Effective APR
Bank One, NA	$30	$150	$45	$195	2,542%
LaSalle Bank, NA	$28	$140	$0	$140	1,825%
Harris Trust & Savings Bank	$27	$135	$65	$200	2,607%
Citibank FSB	$30	$150	$0	$150	1,955%
Northern Trust Co.	$25	$125	$0	$125	1,629%
Fifth Third Bank	$30	$150	$78	$228	2,972%
Charter One Bank, NA	$33	$165	$99	$264	3,441%
MEAN	**$29**	**$145**	**$41**	**$186**	**2,424%**

Disclosure. In addition to these serious implementation problems, the consumers generally do not understand how the bounced check loan programs operate. Advertisements and checking account guides often fail to mention (or state in an unclear way) the following: eligibility requirements for the product; the order in which the bank pays checks and debits; the method by which a customer will be notified of an overdraft; whether or not the service is available through an ATM or debit card transaction; and whether or not the bank has a sustained overdraft fee. In fact, many new customers aren't informed at all that the product will be applied to their account.

Recommendations. Simply stated, when an overdraft is paid, credit is extended. In fact, in the proposed Interagency Guidance and Best Practices, the Federal Reserve Board explicitly admitted these products are an extension of credit.[1] However, a provision in Regulation Z states that fees for paying overdrafts are currently not considered finance charges if the institution has not agreed in writing to pay overdrafts. Enacted under the auspices of TILA, this regulatory exemption was originally intended for the occasional ad-hoc payment of overdrafts. The exemption has since been exploited by the banking industry: with the subsequent automation of financial services, banks are now able to apply this service to virtually all of their accounts and charge exorbitant fees for its use. This regulatory provision seems even more outdated given the technological changes in the industry, most notably the increased use of ATMs, debit cards, and internet transactions.

[1] "When overdrafts are paid, credit is extended…since this regulatory exemption was created for the occasional ad-hoc payment of overdrafts, its application to these automated and marketed overdraft protection programs could be reevaluated in the future." Interagency Guidance on Overdraft Protection Programs, 28 May 2004.

Changes in technology necessitate changes in regulation. Bounce check loans therefore should be covered under the Truth in Lending Act (TILA) as opposed to the Truth in Savings Act (TISA). As discussed above, bounce check loans clearly constitute "credit" and the banks that offer them are "creditors." Because of the expensive costs of bounce check loans, consumers ought to have Annual Percentage Rate (APR) disclosures. Improved disclosure of APR or relevant fees would ensure better consumer knowledge, and allow for comparison among the wider range of loan products available on the market. Even stronger protections are needed on bounced check loans made accessible through ATMs. Since funds availability can be confirmed instantly and since customers are not making merchant penalties or facing embarrassment in an ATM transaction, there is no justification for allowing a consumer to overdraw at an ATM.

We should add that this comment letter does not oppose overdraft programs in general. We are only opposed to bounced check loans that are exorbitantly expensive, that are not accompanied by APR disclosures, that are imposed without affirmative consumer consent, or that are advertised to consumers as an easy source of credit.

Sincerely,

Malcolm Bush
President

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