Release:
December 22, 2008

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Jury's Out on Regulators' New Proposal to Address Abusive Overdraft Loans

Washington, DC—Federal banking regulators yesterday withdrew proposed rules that would have largely failed to protect consumers from astronomically high-cost, unsolicited overdraft loans. The Fed then immediately issued a new proposal containing two alternative approaches. The impact the new proposal will have on abusive fees depends primarily on which approach the Fed ultimately chooses.

Consumers pay $17.5 billion per year in overdraft fees that banks charge after routinely allowing consumers to overdraw their accounts by checks, ACH transactions, ATM withdrawals and debit card purchases. This exceeds the $15.8 billion banks extend in the overdraft loans themselves. Banks automatically enroll consumers in their most expensive overdraft programs, but surveys have found that accountholders overwhelmingly want a choice about whether or not to participate.

Representatives from the Consumer Federation of America, Center for Responsible Lending, Consumers Union, U.S. PIRG, and the National Consumer Law Center are pleased that the weak rule issued by the Federal Reserve, the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) wasn't made final as originally proposed. That proposal failed to require banks to obtain consumers' affirmative "opt-in" before enrolling account holders in their overdraft programs.

In its new proposal, the Fed focuses only on ATM and certain debit transactions. The good news is that the Fed has acknowledged that overdraft fees on these transactions are especially abusive because consumers don't expect to be able to overdraw their accounts at an ATM or debit terminal. Overdraft loans from debit and ATM transactions are astronomically expensive—a CRL study found that the typical overdraft loan triggered by a debit card, incurring a $34 fee, is only $17.

"Debit card overdrafts are costing consumers billions of dollars a year," said Eric Halperin, DC director of the Center for Responsible Lending. "Consumers should have the right to decide whether they want to pay a $35 fee to buy a $5 hamburger."

The Fed's proposal asks for comments on two different approaches. The first maintains the status quo by requiring banks only to permit consumers to opt out of these extremely expensive loans, allowing continued abuses. The second approach would require banks to get consumers' permission *before* covering their ATM and most debit transactions for a fee. We urge the Fed to adopt this second, significantly stronger approach, known as opt-in. Consumers who believe the Fed should adopt the stronger approach should let the Fed know during its open comment period at http://www.federalreserve.gov/generalinfo/foia/ElectronicCommentForm.cfm?doc_id=R-1343&doc_ver=1&name=Regulation%20E%20-%20Electronic%20Fund%20Transfers&date=20081218a.

"We applaud the Fed for proposing that consumers be given the right to opt-in to use overdraft loans, but are dismayed that the Fed did not go further in protecting consumers from what are essentially payday loans," said Jean Ann Fox, director of financial services for CFA.

For instance, the proposed rule does not require that consumers be provided with federal truth-in-lending disclosures about the APR of overdraft loans. A recent FDIC study noted that charging a $27 overdraft fee for a $20 debit card transaction would be the equivalent of a 3,520% APR if the overdraft is repaid in two weeks.

Gail Hillebrand, Consumers Union Financial Services Campaign Manager, added, "Requiring banks to get the opt-in permission of consumers for overdraft fees on debits is a good step forward, but the new proposal seeks comment on whether to impose this common-sense requirement."

Even if it adopts the second approach, the Fed's rule should have gone further still. While the Fed proposed to prohibit most overdrafts caused solely by debit card "holds"—when a hold by a merchant exceeds the actual amount charged—it did not address check holds, when banks intentionally delay the availability of deposits, or banks' ability to manipulate the order in which transactions are cleared in order to maximize overdrafts.

A recent FDIC study confirmed years of previous research on overdraft practices: Banks automatically enroll consumers in the most expensive overdraft option; debit card transactions are the most common trigger of overdraft fees; and lower-income account holders are more likely to pay overdraft fees, stripping what little money they have from their accounts and driving them further into the red.

"Overdraft fees disproportionately affect the most vulnerable consumers, including low-income and young consumers," said Chi Chi Wu, National Consumer Law Center. "Addressing overdraft fees related to ATM and debit transactions is a move in the right direction toward protecting them and all consumers. But we need to do more. Much more."

The FDIC study also found that consumers pay the most overdraft fees when their banks allow overdrafts for ATM and debit transactions and clear transactions in order from highest to lowest to maximize fees.

"Consumers find themselves financially squeezed like never before, " said Edmund Mierzwinski, Consumer Program Director for USPIRG. "While the Fed could have done more, the opt-in proposal, if adopted, would provide some measure of relief for consumers who are essentially being forced to take out payday loans."

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NCLC is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as organizations, who represent low-income and elderly individuals on consumer issues.

CFA 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.

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.

U.S. PIRG is the national lobbying office for the State Public Interest Research Groups. State PIRGs are non-profit, non-partisan public interest advocacy groups.

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.