COMMENTS
to the
Federal Reserve Board's

Proposed Revisions to
Official Staff Commentary to Regulation Z Truth In Lending
regarding Open End Credit and HOEPA Triggers
and
Solicitation for Comments on Bounce Protection Products

Docket No. R-1136
January 27, 2003

I. **INTRODUCTION**

The National Consumer Law Center and the Consumer Federation of America submits these comments as well as the following organizations:

Consumers Union of US, Inc.
National Association of Consumer Advocates
National Senior Citizens Law Center
U.S. Public Interest Research Group

These comments address the Board's proposed revisions to the Official Staff Commentary regarding certain credit card issues and the selection of Treasury yields for determination of the HOEPA trigger. These comments also raise several open-end credit issues that we believe the Board should address.

In addition, these comments address the Board's solicitation for comments regarding the issue of bounce protection plans. On behalf of our low- and moderate-income clients and consumers, we commend the Board for examining the issues surrounding this product, which represents the latest high cost product marketed toward this community. These comments will address why bounce protection fees are finance charges and should be disclosed under TILA; how purveyors of these plans engage in unfair and deceptive acts and practices in promoting and operating them; and what should be done to protect consumers. A separate Appendix provides an in-depth examination of how bounce protection plans are promoted and operated.

II. **OPEN END CREDIT DISCLOSURES**

The Board has proposed revisions to the Commentary to address the treatment of fees imposed for expediting a consumer's payment and whether a change in terms notice is necessary for changes in this fee. The Board has also proposed a revision that addresses the treatment of fees for expediting delivery of a credit card, and a revision that would allow card issuers to send unsolicited duplicate cards in some circumstances. Our comments address these proposals, and in addition suggest other aspects of the rules for open end disclosures that the Board should revise.

A. Expedited Payment Methods

The proposal would revise the Commentary to address fees charged by credit card companies for expedited payment methods, such as electronic funds transfer or a draft on a consumer's checking account. The revision states that such fees are not finance charges but are "other charges," provided that the method of payment was not established as the regular payment method for the account.

We have no objection to the treatment of expedited payment fees as an "other charge," if the creditor does not impose the method and the consumer agrees to it explicitly and affirmatively after disclosure. If the expedited payment method is imposed by the creditor, even if it was not established as the regular method of payment for the account, then it is a charge "payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit" and should be considered a finance charge. We note that this proposal was in response to credit card companies' request for guidance on fees in a situation where the consumer *requests* an expedited payment method, and we recommend that this restriction be made explicit. In addition, since expedited payment methods should be only at the consumer's request, the consumer should be informed of the amount of the fee at the time of the request for the service. The creditor should be required to document that the consumer has been informed of the amount of the fee at the time of requesting an expedited payment method, and has agreed to it.

To incorporate these changes, we suggest that, instead of adding expedited payment fees to § 226.6(b)(i) of the Commentary, the Board create a new Commentary subsection 226.b(b)(1)(viii) for expedited payment fees, stating:

> Charges imposed for expediting a consumer's payment, provided that expedited delivery was affirmatively and explicitly requested by the consumer, was not required by the creditor, and was not established as the regular payment method for the account, and the creditor has documented that, at the time of the consumer's request, the consumer was told of the amount of the fee and agreed to it. Charges for expedited payment that do not meet these criteria are finance charges.

This suggestion is dependent upon a requirement, discussed later in these comments, that notice be given to the consumer in advance about the existence and amount of this fee, i.e., a change in terms notice.

B. Expedited Delivery Fees

The proposes Commentary addresses the treatment of fees charged by credit card companies for expediting delivery of a credit card. The revision would provide that such fees are not finance charges and not "other charges," and hence would not have to be disclosed at all to consumers, so long as delivery by standard mail service at no charge is available.

We are concerned about this treatment of expedited delivery charges. We question why, unlike expedited payment method fees, they are not treated as "other charges." After all, both involve an extra fee for expedited treatment. Consumers should be made aware of both fees, so that they can be fully informed of the costs of choosing expedited service.

Moreover, expedited delivery charges should be disclosed as finance charges in some circumstances. We believe that an expedited delivery fee is a finance charge if the creditor imposes the method without the consumer's explicit and affirmative consent. If the method is required by the credit card issuer, then it is a charge "payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit" and should be considered a finance charge. We are highly concerned that the current proposal excludes these fees from being a finance charge without a requirement that the consumer affirmatively and explicitly agree to expedited delivery. It is not inconceivable that an unscrupulous card issuer would start "expediting" the delivery of all of its cards for a hefty fee, from which consumers would be required to actively opt out.

Again, we note that this proposal was also in response to credit card companies' request for guidance on fees for when a consumer *requests* expedited delivery. We recommend that this condition be made explicit. In addition, the Board's Supplemental Information states for expedited fees that "[c]ard issuers generally inform consumers of the amount of the specific charge at the time the consumer agrees to the expedited service." We recommend that the Board make this practice a requirement, and also require that the creditor document that the consumer has been informed of the amount of the fee at the time of the request, and has agreed to it.

Another issue is that the proposed Commentary does not define the terms "expedited" and "standard mail." We are concerned that unscrupulous card issuers might define "standard mail" as bulk mail, and treat first class mail as "expedited delivery." To address this issue, the Board should state that "expedited" delivery does not include first class mail. Furthermore, the Board should require that fees for expedited delivery bear a reasonable relationship the actual cost of that delivery.

We recommend that the Board not adopt the proposed addition to § 226.6(b)(2) of the Commentary. Instead, the following new Commentary subsection § 226.6(b)(1)(ix) should be adopted, setting forth the rule that expedited delivery charges are "other charges" if they meet certain standards, but otherwise are finance charges:

> Fees to expedite delivery of a credit card, either at account opening or during the life of the account, provided that expedited delivery was affirmatively and explicitly requested by the consumer and was not required by the creditor, the creditor documents that, at the time of the consumer's request, the consumer was told of the amount of the fee and agreed to it, and card delivery is also available to the consumer by standard mail services without paying a fee. First class mail shall

not be considered expedited delivery. Fees for expedited delivery should be reasonable in relationship to the actual cost of delivery. Fees for expedited delivery that do not meet these criteria are finance charges.

This suggestion is dependent upon a requirement, discussed below, that notice be given to the consumer in advance about the existence and amount of this fee, i.e., a change in terms notice.

C. Change in Terms Notices

The proposal would revise Section 226.9(c)(2) to permit imposition of changes in the fee for an expedited payment method without a change-in-terms notice. The explanatory material to the proposal notes that this is consistent with the rules for late fees, the imposition of which also does not require a change-in-terms notice.

For the Board to exempt any fee from a change-in-terms notice by citing late fees is ironic, at best, given recent controversy over late fees. As noted by several consumer groups, credit card companies have been aggressively increasing their income from late fees. Credit card companies have doubled the average late fee from 1992 to 2000. Some less scrupulous credit card companies have been using questionable tactics to increase the imposition of such fees. As a result, credit card companies nearly tripled their fee income between 1995 and 1999, from $8.3 billion to $21.4 billion. Consumer groups have assailed credit card companies for skyrocketing fees and using unfair tactics to impose such fees, and several government enforcement and class action lawsuits have been brought.

The Board should amend this section by requiring change-in-term notices for late fees, these new expedited payment fees, *and* the new expedited delivery fees. Consumers are entitled to be informed when their credit card companies add or raise the amount of a fee, especially when these fees have been increased dramatically over the span of a few years. The fundamental purpose of TILA and Regulation Z is to inform consumers of the cost of credit, so that they can make informed credit choices. Increasingly, information about late fees and other non-finance charges is exactly the sort of information consumers need when shopping for a credit card or determining whether to continue to use an existing card.

Thus, we recommend that the Board delete Section 226.9(c)(2)(vi) of the Commentary.

D. Exception to the One-for-One Rule

The proposal would revise the Commentary to permit card issuers to replace an accepted credit card with one or more renewal or substitute cards on the same account, provided that:

Any replacement card accesses only the account of the accepted card;
All cards issued under that account are governed by the same terms and

conditions; and

The consumer's total liability for unauthorized use for that account does not increase.

We believe that a fourth proviso should be added to this exception to the one-for-one rule - that either all replacement cards be mailed in the same envelope or that the consumer be notified in writing that a second renewal or substitute card is being mailed.

As the Supplementary Information notes, the "one-for-one rule " was developed to implement the prohibition of Section 132 of TILA against unsolicited mailing of credit cards. This section was enacted as a response to numerous problems with unsolicited credit cards, including concerns about theft and liability for unauthorized use.

If renewal or substitute cards are mailed in the same envelope or if the consumer is aware that multiple cards will be mailed in separate envelopes, this proposal does not raise any additional concerns regarding theft and unauthorized use. However, if the cards are mailed in separate envelopes without the consumer being informed, there is an additional risk that the second card might be stolen in the mail. The consumer would be unaware of any theft.

We understand that the proposed changes protect the consumer from liability for unauthorized use due to theft. However, that protection is not automatic. The card issuer still has the option of attempting to prove that the use of the card was authorized. In addition, in many cases of identity theft and theft of credit cards, negative credit reports start appearing on the consumer's credit record before the consumer is even aware of the theft. These negative credit reports can have long-term, intractable, severe consequences to consumers. But even if theft of credit cards caused no harm at all to consumers, the risk of loss to lenders and merchants can be reduced by the simple addition of the requirement that duplicate cards not be mailed in a separate envelope unless the consumer is informed in advance.

The Supplemental Information mentions that card issuers now use measures to prevent theft by sending cards that are not activated, and then requiring the consumer to verify receipt of the card. However, not all card issuers may employ such measures and neither Regulation Z nor the Commentary requires such measures. We recommend that the Board also consider requiring these measures.

In the Supplemental Information, the Board solicits comment on whether this exception to the one-for-one rule should be applied even when there is no renewal or substitution for the cardholder's existing card. We would oppose such an application unless it required that the consumer be given 7 days written notice in advance that a duplicate of his/her credit card is being sent. Theft of a card sent at any other time is much more likely to go undetected, because the cardholder is not expecting it. Thus, if this exception to the one-for-one rule were to be expanded, the Board must require the card issuer to provide adequate advance notice to the consumer that a card will be arriving in the mail.

E. Other Open-End Credit Issues

We also urge the Board to address other improvements that are needed to make disclosure of open-end credit terms effective:

· *Better disclosures for home equity lines of credit*: HELC disclosures should be revamped from top to bottom. Current HELC disclosure requirements do not give consumers usable or accurate enough information at either application or closing. The Board should require a reasonable estimate of the payment terms, the finance charge, and the total of payments for these open end loans. For variable rate credit, the creditor should be required to illustrate the effect of the worst-case scenario rate increase on the consumer's actual loan amount, not an arbitrary $10,000 loan. Technology now makes it easy for creditors to tailor disclosures to the consumer's particular loan terms in this way. The Board should also require better disclosure of the non-interest charges that are currently excluded from the annual percentage rate for home equity loans, and should adopt clearer and simpler model forms for HELCs. We would be happy to propose more the format and language for an improved HELC model disclosure form.

· *Putting the truth back in Truth-in-Lending*: The credit card industry is rife with bait and switch offers. The Board's stricter requirements for disclosure of teaser rates, effective October 1, 2001, address bait and switch tactics that relate to the APR, but the industry continues to advertise other terms that are withdrawn shortly after consumers accept a card. In 2002, in *Rossman v. Fleet Bank*, the Third Circuit held that a creditor violated the Truth in Lending Act by offering "no annual fee" and then imposing a fee less than a year later. We urge the Board to incorporate the *Rossman* holding by establishing rules about how long an advertised or disclosed credit term has to remain true.

· *Deterring Spurious Open-End Credit*. We strongly urge the Board to revive its December 7, 1997 proposal, which articulates five factors to be considered when determining whether a credit transaction is truly open-end. In addition, we urge the Board to close the information gap between close-end and open-end disclosures.

· *Over-limit fees as finance charges*. Currently, Regulation Z § 226.4(c)(2) appears to exclude over-limit fees categorically from the definition of finance charge. The Sixth Circuit held in *Pfennig v. Household Credit Services*, Inc. that the plain language of TILA requires an over-limit fee to be treated as a finance charge if it is imposed by the creditor as a condition of an extension of credit that exceeds a credit limit. Credit card fees have skyrocketed during the past decade. They are a significant source of profit for credit card companies, and thus function much the same as interest from the creditor's point of view. Yet the relaxed disclosure requirements for these fees enable creditors to reap rich profits at the expense of unsuspecting consumers. Disclosing the true cost of over-the-limit fees is information consumers need in shopping for a credit card. We recommend that the Board revise both Regulation Z and the Staff Commentary to reflect the holding in *Pfennig*.

· *Prominence of critical disclosures*. A major credit card issuer recently changed its periodic statement format so that the total unpaid balance is no longer disclosed at the top of the bill, but is buried at the bottom. Even though that creditor withdrew the change about a week later, the incident highlights the need for greater specificity in the disclosure requirement. Creditors who seek to encourage consumers to stay in debt are likely to disclose the balance in a way that downplays it. We urge the Board to propose a rule that would require the balance on which the finance charge is computed to be disclosed near to the minimum payment each time the minimum payment is disclosed.

· *Term and payoff at minimum payment*. The number of consumers who make only minimum payments on their credit cards, thereby consigning themselves to virtually perpetual debt, threatens not only the income security of families but also the safety and soundness of banks. At least one state has attempted to require disclosure on consumers' bills of the effect of making just the minimum payment. We urge the Board to take the lead on this issue and require disclosure of the term and finance charge if the consumer makes only the minimum payment.

III. **PROPOSED AMENDMENTS TO THE HOEPA TRIGGER RULES**

The Board is proposing three amendments to the Commentary to Regulation Z § 226.32, all relating to the calculation of the APR trigger that determines whether a loan is subject to the Homeownership and Equity Protection Act. We support the first and third proposals and consider the second proposal the best of the available alternatives, none of which is entirely satisfactory.

A. Use of Actively Traded Treasury Securities Adjusted to Constant Maturities.

For certain short-term loans (up to six months), the Treasury Department offers more than one type of security with comparable maturities. Creditors have asked for guidance about which type of security to use when calculating the APR trigger. The Board's proposal specifies that creditors must use the rates for actively traded Treasury securities adjusted to constant maturities, as listed on the Treasury Department's H-15 Statistical Release.

This proposal will bring clarity, certainty, and simplicity to the calculation of the APR trigger. Calculation of the HOEPA triggers is necessarily technical, given the requirements of the statute. To the extent that the Board's regulations and Commentary can minimize the complexity and uncertainty of these calculations, it will increase creditor compliance, enhance monitoring and enforcement by consumers and government agencies, and increase understanding of the law. We support this proposal and commend the Board for making it.

B. Loans With 30-year Maturities

HOEPA sets the APR trigger by referring to Treasury securities having comparable maturities. Unfortunately, on February 18, 2002, the Treasury Department ended its publication of rates for 30-year securities. Since 30 years is a common term for home-secured credit, the Treasury Department's action creates a significant gap.

The Board's proposed solution to this problem is to direct creditors to use the rate for 20-year securities when calculating the APR trigger for 30-year loans. The result is a higher APR trigger than was true when 30-year rates were available, so fewer 30-year loans will be subject to HOEPA's protections. HOEPA's protections are extremely important in combating predatory lending, so the Board should be highly reluctant to adopt interpretations that increase the APR trigger.

Unfortunately, there does not appear to be a better alternative at present. The Treasury Department also publishes a long-term average yield for securities with terms of 25 years and over, and an "extrapolation factor" that can be added to this figure to estimate a 30-year rate. However, at least during the eleven months that the Treasury Department has published these figures, neither figure has uniformly preserved the rate drop that the 30-year securities historically showed. In addition, while using the long-term average yield would not be complex, using that yield plus the extrapolation factor would add complexity to HOEPA calculations.

We therefore endorse the Board's proposal to instruct creditors to use the 20-year rate to calculate the APR trigger for 30-year loans on an interim basis. However, we urge the Board to continue to explore other alternatives that might reflect the drop in prime rates for 30 year mortgages. We also urge the Board to consider further revisions if Treasury begins publishing a more suitable rate.

C. Use of Actual Auction Results

The Board also proposes to revise the Commentary to eliminate the option to use yields of actual auction results as an alternative to the rates published in the H-15 Statistical Release. We strongly support this proposal.

Since Treasury auctions are held infrequently, they are less likely to reflect market conditions at the time the borrower applied for credit. Allowing creditors this choice invites them to pick and choose the standard that will allow them to charge the highest APR without affording the HOEPA protections to the borrower. The former interpretation undermined HOEPA by allowing creditors this means of evading its protections.

Treasury auction results are also less readily accessible than the H-15 Statistical Release. Establishing the H-15 Statistical Release as the sole benchmark means that creditors, consumers, and regulators will only have to check a single, easily-accessed document to determine the APR trigger for a transactions. This change will reduce the complexity of HOEPA calculations and promote certainty, simplicity, and understanding.

IV. **BOUNCE PROTECTION PLANS**

The Board has solicited information and comments on how "bounce protection" services are designed and operated, as well as how this product should be treated for purposes of TILA and other laws. We commend the Board for focusing attention on the highly abusive practices that pervade the growing bounce protection plan industry.

Bounce protection plans represent the banking industry's foray into payday lending, promoting an extremely high-cost credit product to low- and moderate-income consumers. Bounce protection plans are marketed deceptively and without meaningful disclosure. We believe the Board should prohibit bounce protection plans as they are currently promoted to consumers by:

Requiring that TILA disclosures be made for bounce protection.

Prohibiting deceptive advertisement of bounce protection plans, such as advertising, representing, or implying that consumers should have the expectation bounce protection will cover overdrafts, but then stating in contract documents that paying overdrafts is discretionary.

Prohibiting banks from advertising or promoting any plan that encourages consumers to write NSF checks or take other steps that might have criminal consequences.

Forbidding banks from imposing bounce protection on consumers without the consumer's affirmative consent.

Prohibiting banks from promoting bounce protection plans without informing consumers of other less expensive alternatives.

Prohibiting banks from seizing customers' exempt funds (e.g. SSI benefits deposited directly into the account by the Social Security Administration) to repay the debt.

A. The Nature and Operation of Bounce Protection Plans

Bounce protection is a new form of overdraft protection that a number of banks are marketing aggressively as a means of boosting their non-interest revenue at the expense of the most vulnerable consumers. These products are not traditional overdraft lines of credit or a bank's occasional ad hoc practice of covering a consumer's bounced check as a courtesy. Instead, they are deliberate, systemic attempts to hook consumers onto overdrafts as a form of high cost credit. The nature of bounce protection plans is summarized here and described in detail in the Appendix to these comments.

Bounce protection plans offer short-term credit at triple-digit rates. A $100 advance will typically carry at least a 243% APR if paid in 30 days and 541% if paid in 14 days. Banks usually charge a per item fee, generally the bank's standard NSF or overdraft fee of $20 to $35. Some banks also charge a per day fee, such as $2 or $5 per day, until the consumer's account has a positive balance. Yet banks claim that they are not required to give Truth in Lending disclosures regarding the cost of bounce protection.

Banks market bounce protection plans to consumers the same way payday lenders do. One bank's pitch is: "Access your Paycheck Before you have it! Sound too good to be true? Well it isn't, you can now start writing checks before you get paid without the worry of returned checks." Bounce protection advertisements also consistently contradict the industry's assertions that bounce protection is "discretionary," which they do to avoid TILA coverage. For example, one bank states: "you will know that your checks, ATM withdrawals, Visa Check Card Purchases, and other transactions will be honored up to your Bounce® Protection Limit." When a consumer with a bounce protection plan makes a transaction at an ATM, the transaction slip typically lists the bounce protection ceiling as "available."

When a consumer uses bounce protection, the bank deducts the amount covered by the plan plus the fee by setting off the consumer's next deposit. This is true even when the deposit is protected income, such as a welfare or a Social Security check.

A characteristic feature of bounce protection plans is that consumers do not affirmatively agree to coverage. Instead the bank imposes coverage on a subset of account holders as a "courtesy" or additional service feature of their account. Consumers who do not want this "courtesy" must explicitly opt out by contacting the bank. One consulting firm that markets bounce protection plans to banks claims that its program is designed to result in coverage of 90 to 95% of a bank's consumer checking customers.

A handful of bank consultants are responsible for the creation of bounce protection plans, marketing them to thousands of banks. These consultants typically offer an entire programmatic package, including the software, customer marketing materials, and consultant support to implement the programs at banks. These consultants repeatedly emphasize increase in fee income as the major selling point for banks. For example, Pinnacle's website promises banks that will raise overdraft fee income by "100%, 200%, 300% or more!" 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.

B. Bounce Protection Plans Must Give TIL Disclosures to Consumers

Given the pitfalls and abuses presented by bounce protection, we urge the Board to require purveyors of such programs to make disclosures under TILA and Regulation Z. The following analysis will show why the fees for these products should be treated as finance charges and TIL disclosures required.

1. <u>Bounce Protection Constitutes Credit.</u>

There is no question that bounce protection is credit as defined by section 1602(e) of TILA. When a bank uses its funds to pay for an overdraft, and then requires the consumer to repay the bank, it is granting the consumer right to "incur debt and defer its payment." In fact, many banks explicitly state that consumers who use this product have the right to defer payment for certain number of days. The Office of Comptroller of Currency has recognized that bounce protection is credit as defined by TILA: "An overdraft would be "credit," as defined by the Truth in Lending Act and Regulation Z." State regulators have reached the same conclusion.

The truth of this conclusion is demonstrated most clearly by the banks themselves that offer bounce protection. Banks market bounce protection as credit. One bank advertises "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 advertises "Access your Paycheck Before you have it!" These typical pitches, many more examples of which are set forth in the Appendix, are a telling demonstration of the falsity of any argument that bounce protection is not credit.

2. Fees for Bounce Protection Products Are Finance Charges

In order for TIL disclosures to be required, bounce protection must not only be "credit," but the bank must meet the statutory definition of "creditor," i.e. it must be extending credit that is payable by agreement in more than four installments or for which a finance charge is or may be required. 15 U.S.C. § 1602(f). Since credit extended under a bounce protection plan is generally not payable in more than four installments, we will focus on the question whether the charges imposed for bounce protection are finance charges.

Bounce protection plan charges are a major source of profit for banks, and are marketed as such. These charges function the same as finance charges from the creditor's point of view. We believe that the plain language of TILA confirms this common sense approach and requires that bounce protection fees be treated as a finance charge. In addition, given the actual way in which bounce protection plans operate and are described to consumers in banks' literature, we contend that the fees fall within Regulation Z's definition of finance charges.

a. Bounce Protection Fees Meet TILA's Definition Of "Finance Charge" Under Section 1605(a)

Before turning to an analysis of Regulation Z, we need to examine the language of TILA itself to determine whether bounce protection fees constitute a finance charge. The starting point for interpreting TILA is the language of the statute itself.

The plain language of TILA requires that the fees for bounce protection products should be considered a "finance charge." Section 1605(a) defines a "finance charge" as " any charge payable directly or indirectly by the consumer, and imposed by the creditor as an incident to the extension of credit." Fees for bounce protection meet each element of this definition. They are payable by the consumer, imposed by the creditor, and incident to the extension of credit.

We recognize that Section 1605(a) of TILA exempts from the definition of "finance charge" any fee "of a type payable in a comparable cash transaction." The question is what cash transactions, if any, are comparable to an extension of credit under a bounce protection plan.

We submit that there is no cash transaction that is comparable to the extension of credit that bounce protection plans promote. For a credit sale, the comparable cash transaction is the sale of the same goods or services for cash. But with a bounce protection plan what the consumer is getting is cash. It is not at all clear that Congress intended the exception for charges imposed in comparable cash transactions to apply to non-purchase money loans. If this analysis is correct, then the "comparable cash transaction" exception should simply not be an issue in analyzing bounce protection transactions.

Regulation Z and the Commentary, however, appear to treat an overdraft on an account without a credit feature as a cash transaction comparable to an overdraft on an account with a credit feature. We submit that these sections are illogical and stray from the intent of the statutory language. What the banks have appeared to assume is that because the NSF fee for a returned check and a bounce protection fee are the same, the transactions themselves comparable. Just because the banks have used the same dollar amount for both transactions, however, does not make them comparable. Otherwise, creditors would be able to avoid TIL responsibilities by making their finance charges the same dollar amount as an unrelated fee in a cash transaction.

Furthermore, this reasoning does not apply at all when it comes to the per day fee that some bounce protection 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. Even a consultant who promotes bounce protection has conceded that per day fees are finance charges and has warned against imposing them.

For certain types of bounce protection transactions it is even clearer that there is no comparable cash transaction. The argument for comparability completely breaks down when it comes to non-check methods of accessing bounce protection, such as access through ATMs, debit cards, on-line banking transactions, and other payment methods. For many of the payment methods listed, there are no comparable cash transactions. Consider this example noted by the Indiana Department of Financial Institutions:

> A consumer who has a $0.00 balance in their checking account attempts to make a $200.00 withdrawal at an ATM. If the consumer has [bounce protection], the consumer receives $200.00 from the machine and is charged a standard overdraft fee ($20.00-$25.00) for this service. . . . If the consumer does not have the protection of the Program, the consumer receives $0.00 from the machine and is charged nothing for making the attempt.

In this example, the bounce protection fee is clearly a finance charge, because there is no fee for the allegedly comparable cash transaction - indeed, there is no transaction at all without bounce protection. This is also true for when bounce protection is accessed by debit cards, checks written to "cash" presented to a teller, and on-line banking account transfers.

For all of these reasons, the fees charged for bounce protection plans are finance charges.

b. Bounce Protection Charges Are Finance Charges Under Regulation Z

Bounce protection fees should not be exempted from finance charges under Section 226.4(c)(3) of Regulation Z, which excludes fees for traditional overdrafts. Regulation Z provides that overdraft fees are finance charges only when "the payment of such items and the imposition of the charge were previously agreed upon in writing."

Purveyors of bounce protection programs have attempted to avoid the requirements of Regulation Z by squeezing these programs into the confines of section 226.4(c)(3). They do so by stating that the payment of overdrafts is "discretionary," and arguing therefore they have not "agreed in writing" to pay overdrafts.

However, it is clear that these bounce protection plans are not discretionary. As the industry itself states, these plans are run by computer software that automatically permits overdrafts when criteria are met. By handing over the decision to computer software, bounce protection is no longer an occasional and discretionary action, but a formal written and agreed upon practice.

Furthermore, when banks pay overdrafts under a bounce protection plan, they are doing so pursuant to an agreement in writing. There are numerous examples, some of which are reproduced in the Appendix, of written statements made by banks that represent or imply that banks have agreed to pay overdrafts. For example, one bank advertises "Overdraft Privilege gives you the peace of mind that your checks will be honored, up to an overdraft of $500 ($300 for Free Checking)!" Another advertises: you will know that your checks, ATM withdrawals, Visa Check Card Purchases, and other transactions will be honored up to your Bounce® Protection Limit." and "Remember, checks drawn up to the limit will not be returned, saving you the embarrassment and expense associated with the returned check fee. This privilege can save you money" Indeed, the banks' statement that the consumer has an "available balance" that includes the bounce protection "limit" is a representation that the bank has agreed to pay overdrafts.

Section 226.4(c)(3)'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 or a provision in a customer agreement. A bank can agree in writing to pay overdrafts by representing or implying that it will do so in advertisements, correspondence, or in an FAQ section on its website. 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.

From a broader perspective, we submit that bounce protection fees should not be excluded under Section 22.6(c)(3) because this section was originally intended to exempt overdraft fees for the traditional situation in which a bank, on an ad hoc and occasional basis, covers a consumer's bounced check as a customer courtesy. We believe in issuing Section 226.4(c)(3), the Board never contemplated excluding fees for a program in which banks systemically extended credit and charged fees for this credit. We note that in the revisions to Regulation Z in 1980 as a result of TIL Simplification, the Board had proposed an amendment to section 226.4(c)(3) which would have limited the exclusion for overdraft charges to "an inadvertent overdraft." We urge the Board to revisit this issue and to consider revising Regulation Z's criteria for excluding overdraft charges from finance charges.

Instead of excluding overdraft charges from the definition of finance charges when there is a written agreement that the bank will pay the overdrafts, the Board should consider excluding charges that are imposed for occasional, inadvertent, or unanticipated overdrafts. This approach would prevent banks from claiming that bounce protection fees were not finance charges because of fine print in the contract that gave the bank some discretion, whether exercised or not, to decline to cover an overdraft. Instead, the question would be whether the parties anticipated overdrafts. The Board has already adopted this same approach for determining whether a late charge is a finance charge: charges for "actual unanticipated late payments" are not finance charges. Regulation Z § 226.4(b)(2). The Board also follows this approach with respect to debit cards. Section 226.2(a)(15)(2)(ii)(A) of the Commentary excludes from the definition of credit card: "A check-guarantee or debit card with no credit feature or agreement, even if the creditor *occasionally honors* an inadvertent overdraft." (emphasis added).

It is the systematic nature of bounce protection that requires that their fees be considered finance charges. This is not a simple occasional customer courtesy. This is a deliberate attempt to generate massive fees by allowing, and encouraging, consumers to overdraw their accounts as a form of expensive and highly addictive credit.

Focusing on whether the parties anticipated the overdraft rather than on the terms of the agreement would also be consistent with the views of the Sixth Circuit in *Pfennig v. Household Credit Services* with respect to over-the-limit fees:

> [I]n situations where the consumer is in default, is delinquent in payment, or submits an unanticipated late payment, the lender is placed in a position of *unexpectedly* having to bear the costs of the borrower's tardiness …. However, the scenario is entirely different where, as here, the borrower has reached her credit limit, requests more credit, and the lender agrees to that extension of extra credit, but assesses a fee as a result.

295 F.3d 522, 531 (6th Cir. 2002) (emphasis in original).

Like a late fee, an NSF fee is compensation for the bank when it has to *unexpectedly* bear the costs of the consumer's supposed misbehavior. A bounce protection fee, like an over-the-limit fee when additional credit is extended, is a fee assessed when the consumer requests credit and the lender agrees to the extension of credit. For all of these reasons, bounce protection fees are finance charges.

3. <u>TIL Disclosures About Bounce Protection Plans Are Critically Important for Consumers</u>

The importance of treating bounce protection plans as extensions of credit subject to TILA is heightened by the nature of this particular loan product and the manner in which it is marketed to consumers. If calculated as finance charges, the Annual

Percentage Rates for bounce protection fees are astronomical. 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 541%. Iowa regulators have described an example of an overdraft with an APR of 1520%. Bounce protection plans are much more expensive than alternatives that most banks offer, such as overdraft lines of credit, linking the account to a credit card, and transfers from savings.

Further, banks market bounce protection as short-term loans. For example, one bank advertises that its plan is for people who "run short of cash between paydays." The consultants who promote bounce protection plans tell banks that the plans will help them compete for payday loan customers. Yet consumers are lured into these short-term extensions of credit without ever getting the basic disclosures that would enable them to compare these loans to other alternatives or make the decision to forego the loan altogether.

The need for disclosure of the cost of credit for bounce protection could not be plainer. However, banks are able to conceal these APRs by using a supposed loophole in Regulation Z. We take the position that TIL and Regulation Z are already clear enough in defining bounce protection plans as credit and bounce protection fees as finance charges. But if the Board perceives any ambiguity, the only action consistent with the purposes of the Truth in Lending Act is to amend Regulation Z so that coverage of bounce protection plans is unequivocal.

C. In Promoting and Operating Bounce Protection Programs, Banks are Engaged in Deception and Unfair Practices Which the Board Should Prohibit.

The methods used banks and their consultants to promote and operate bounce protection programs are unfair and deceptive. The Board should use its power under 15 U.S.C. § 57a(f) to declare these practices unfair and prohibit regulated financial institutions from engaging in them.

1. <u>Use of Contradictory And Deceptive Language</u>

Banks engage in deception when they advertise and imply that consumers can rely on bounce protection to pay an overdraft, then state in fine print elsewhere that payment of an overdraft is at the bank's sole discretion. The two types of representations are in direct contradiction to each other, and one of them must be false. The banks that promote bounce protection are trying to straddle the line between not promising to pay checks while assuring their customers it is safe to write overdraft checks. They should not be permitted to so.

Furthermore, when banks entice consumers into making overdrafts by promoting bounce protection as reliable, providing "peace of mind," or helping the consumer "Access your Paycheck Before you have it," consumers begin to rely on the product. Consumers are likely to take advantage of bounce protection only if they really believe the bank will make good on the check. For banks to turn around and claim that bounce protection is discretionary is an unfair and deceptive practice.

2. <u>Enticing Consumers Into Overdrawing their Accounts</u>

Banks that promote bounce protection are encouraging vulnerable consumers to overdraw their accounts. Not only are they encouraging the same bad financial practices which NSF fees were originally imposed to deter, they are encouraging consumers to commit an arguably criminal offense. The Indiana Department of Financial Institutions has even warned bankers against enticing consumers to unwittingly commit a criminal offense, stating:

> Under [Indiana law], it is a Class A misdemeanor when a person knowingly or intentionally issues or delivers a check knowing there are insufficient funds in the bank. 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.

Enticing consumers into committing an act that may have criminal consequences is an unfair act, which the Board should prohibit.

3. <u>Cramming Bounce Protection Plans is an Unfair Practice</u>

Banks achieve the phenomenal growth in overdraft fee income that bounce protection consultants promote by cramming bounce protection plans: i.e., imposing them on consumers who have not requested them. Consumers do not affirmatively agree to coverage; instead the bank imposes coverage to a subset of account holders as a "courtesy" or additional service feature of their account. Consumers who do not want this "courtesy" must explicitly opt out by contacting the bank.

The fact that banks are imposing bounce protection on consumers without their affirmative consent is also an unfair practice. As discussed above, there is no question that bounce protection is credit. Without consent, banks are imposing involuntary loans on consumers. Furthermore, some consumers may not be aware until they overdraw their account that they are accessing a high cost credit product. This would be especially outrageous in the ATM or debit card context, where consumers without bounce protection ordinarily do not incur fees when they try to overdraw their account. The Board should prohibit this practice as unfair.

4. <u>Failure to Inform Consumers of Alternatives</u>

Another unfair and deceptive practice of banks that promote bounce protection is that they fail to inform consumers who are heavy users of bounce protection of less expensive and more financially responsible alternatives. There are a number of more reasonable alternatives that most banks offer, including overdraft lines of credit, linking the account to a credit card, and transfers from savings. In addition, banks might discuss with chronic overdrafters other forms of more reasonable credit.

Instead, banks that promote bounce protection hook consumers -- without their consent -- to the most expensive and abusive form of credit, the kind of credit with APRs that exceed even payday lenders and loan sharks. These banks withhold information about their favorable and straightforward products while automatically enrolling consumers into this abusive product. There is no evidence that banks tell consumers about less expensive alternatives when consumers begin to get into trouble with this product. Instead, the evidence indicates that banks raise the bounce protection limit for heavy users and encourage them to come back for more. Consultants who market bounce protection recommend that banks send "thank you" letters rather than dunning letters for overdrafts, make overdrafts "OK" by allowing debit card and ATM withdrawals, and being friendly to overdraft customers. The Board should require banks to inform consumers of the terms of alternatives to bounce protection plans.

5. Seizure of Exempt Funds Directly Deposited Into the Consumer's Bank Account

A final unfair practice that pervades the bounce protection industry affects consumers who receive Social Security, Supplemental Security Income (SSI), or Veterans Assistance benefits that are directly deposited into their bank accounts by a government agency. Federal law exempts these benefit payments from attachment or garnishment, yet banks claim the right to seize these benefits to repay bounce protection debts as soon as the government agency makes the deposit into the consumer's bank account.

The Ninth Circuit recently held that the bank could seize directly-deposited SSI benefits to pay bounce protection debts despite the protections of the exemption statute. But the Ninth Circuit did not address whether seizure of exempt funds is a fundamentally unfair practice. We urge the Board to conclude that it is an unfair practice, and to prohibit it.

In 1985, the FTC held that consumers subject to the standard form adhesion contracts offered them by creditors should be protected from creditors' ability to obtain wage assignments in those contracts. When the FTC evaluated the fairness of allowing creditors to include wage assignments and other onerous provisions in loan documents, it concluded that consumers cannot reasonably avoid these creditor remedies, because they were standard in the form credit agreements offered to these consumers. The situation is even more extreme with bounce protection: consumers not only have no ability to negotiate the terms of bounce protection plans, but these plans are added to their accounts without any affirmative request. The harm to consumers is profound. SSI beneficiaries are by definition elderly or disabled and poor. Once on the debt treadmill created by a bounce protection loan, many beneficiaries will find it impossible to walk away. Each month the bank will seize not only the previous month's loan from the consumer's benefits, but also the bounce protection fee, leaving the beneficiary without enough income to pay for basic necessities. The beneficiary's only choice will be another bounce protection loan. The Board should prohibit this unfair practice.

4. Recommendations

Bounce protection is an expensive, addictive, and abusive form of credit thrust upon unwitting consumers. The Board should regulate bounce protection plans by doing the following:

> Require that TIL disclosures be made for bounce protection, including per item and per day fees. Require that disclosures be made at ATMs when consumers withdraw cash.
>
> Prohibit as unfair and deceptive any statement that bounce protection is "discretionary" when the banks have advertised, represented or implied that consumers should have the expectation that bounce protection will cover overdrafts.
>
> Prohibit as unfair the advertisement or promotion of any plan that encourages consumers to write NSF checks.
>
> Prohibit banks from imposing bounce protection plans on consumers without their affirmative consent by declaring the practice unfair under 15 U.S.C. § 57a(f) . The Board could exempt that type of pre-bounce protection overdraft coverage that is really an ad hoc occasional courtesy, but the exemption would need to exclude any overdraft plan that is promoted to consumers or operated by one of the consultant software programs.
>
> Prohibit banks from promoting bounce protection plans without informing consumers of the terms and advantages of other alternatives.
>
> Prohibiting banks from seizing customers' exempt funds (e.g. SSI benefits deposited directly into the account by the Social Security Administration) to repay the debt.