APPENDIX

BOUNCE PROTECTION: HOW BANKS TURN RUBBER INTO GOLD BY ENTICING CONSUMERS TO WRITE BAD CHECKS
An Examination of Bounce Protection Plans

Consumer Federation of America
National Consumer Law Center

Banks are aggressively marketing a new form of high cost credit intended to boost their fee income at the expense of the most vulnerable consumers. These products are based on overdraft protection, but are not traditional overdraft lines of credit or the occasional ad hoc practice where a bank will cover 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. To distinguish these products from traditional overdraft lines of credit and from the occasional, ad hoc coverage of an overdraft, we will refer to these plans as "bounce protection."

1. Description of Bounce Protection Plans

Bounce protection works like this: Participating banks advertise to consumers that they will cover overdrafts up to a set limit for accounts in good standing and will charge the bank's standard non sufficient funds (NSF) fee for each overdraft. While plans vary by bank and by the consultant's program employed by each bank, some common features are characteristic of these plans are:

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.

A much larger proportion of bank customers are covered, compared to traditional overdraft lines of credit, because customers do not sign up for the plan.

All participating banks impose a per item fee, generally the bank's standard NSF or overdraft fee which is usually a flat $20 to $35. Some banks also charge a per day fee, such as $2 or $5 per day, until the consumer has a positive balance in her account.

Banks deduct 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 social security check.

Bank customers are not given Truth in Lending disclosures regarding the cost of bounce protection, which can be astronomical.

Bounce protection coverage can be accessed through payment methods other than checks to third parties, including:

- ATMs
- Debit Cards
- Checks and other debits cashed at the teller windows

- Online banking or voice banking line
- ACH debit transactions

- Consumers are informed they have bounce protection "limits," which are shown as "available" amounts when consumers access information about account balances. At ATMs, the account balance includes the amount of the bounce protection (but the ATM does not disclose the fee for accessing cash from bounce protection.) Some banks include the bounce protection limit in the available balance quoted in online banking and telephone banking. However, some banks do not enforce these limits and allow consumers to exceed them.
- Overdrafts must be repaid or accounts brought to a positive balance within a set period of time, generally anywhere from a few days to 30 days.

Each bank's program sets its criteria for participation, generally requiring that the account be open for a certain time, that there are regular deposits to the account, and the lack of defaults or levies. The interpretation of "regular deposits" can vary - the Indiana Department of Financial Institutions noted that one bank only required a deposit of $500 or more in the account each month, while another bank defined it as simply bringing the account to a positive balance at least once every month.

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%. These APRs are probably the bottom end of the scale. However, banks are able to conceal these APRs by using a supposed loophole in Truth in Lending law.

2. Who Sells and Promotes Bounce Protection Plans

Banks themselves generally do not develop bounce protection plans on their own. A handful of bank consultants are responsible for the creation of bounce protection plans, marketing them to thousands of banks. A list of these consultants is included at the end of this report.

These consultants typically offer an entire programmatic package, including the software, customer marketing materials, and consultant support to implement the programs at banks. In some cases, these consultants deliberately package bounce protection plans with "Free Checking" programs. Federal regulation permits a bank to call a checking account "free" as long as there is no regular maintenance fee even though the account may be structured with the purpose of charging high fees.

Over 1000 banks, mostly smaller community banks, have implemented bounce protection plans. Of the large national banks, Washington Mutual Bank appears to be the largest provider of bounce protection. Other large banks offering bounce protection include TCF of Minneapolis and Fifth Third of Cincinnati. To get a sense of whether banks subject to all of the federal regulatory agencies were adopting "bounce protection," we conducted an Internet search using the Google search engine on the phrases "overdraft privilege" and "bounce protection." This search turned up 32 FDIC regulated banks, five

Federal Reserve regulated banks, 15 national banks, 3 thrifts, and a Texas credit union. This was not an exhaustive search, but demonstrates that all types of bank charters are adopting these programs

3. Bounce Protection Advertisements Entice Consumers with the Availability of Credit

Banks and their consultants have aggressively marketed bounce protections plans to consumers as a form of credit that the consumers can draw upon. The following are some sample advertisements for bounce protection:

> First Federal Bank's "Power*draft*" brochure states: "Have you ever made a mistake in your checkbook? Have you ever been shopping on the weekend and find a must-have item, but don't have the money in your checking account to cover your check? 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."
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> Although The Cecilian Bank claims that its "Hometown Coverage" is not a loan, it describes these benefits: "Hometown Coverage will save you merchant and retailer fees and embarrassment when you simply make a mistake in your checkbook, have unexpected emergencies, or **run short of cash between paydays** up to a maximum of $500. Instead of returning checks unpaid, The Cecilian Bank may automatically pay them for you with the use of Hometown Coverage."
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> "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." This is on the web site for First National Bank & Trust Company, Oklahoma, advertising their bounce protection service.
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> Sample advertisement from Pinnacle Financial Strategies, a bank consultant marketing bounce protection: "Take the Headache Out of Checking Account Overdrafts. Bouncing a check can be just down right humiliating! Not to mention those dog gone fees from the merchant. We've taken the headache out of overdrafts and the bite out of some of those excess charges you face on the merchant side. Our overdraft privilege gives you peace of mind you deserve and a lot less headache."

The advertisements also consistently contradict the industry's assertions that bounce protection is "discretionary," which they do to avoid Truth-in-Lending coverage. Ad after ad for bounce protection emphasize the reliability and "peace of mind" provided by this product. For example:

> Benton Banking Company states "The newest addition to our line of services is Free Checking and Overdraft Privilege. Overdraft Privilege gives you the peace of mind that your checks will be honored, up to an overdraft of $500 ($300 for Free

Checking)!"

Washington Mutual states: "Overdraft Protection: Did that last check catch you off-guard? Don't worry, we've got you covered."

First Community Bank of Washington: "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"

A bank trade group representative has touted bounce protection by stating "You can view it as an insurance policy."

These assurances of credit availability extend to non-check methods of accessing a bank account. For example, a sample "Dear Customer" letter from Pinnacle states: "Your Bounce Protection limit will be available to you at the ATM. If you make an inquiry at the ATM, your balance (including Bounce Protection Limit) will be given."

4. Overdrafts Prior to Bounce Protection

Prior to bounce protection, banks have traditionally charged NSF fees as a penalty, to discourage account holders from writing checks without funds on deposit to cover them. Banks charge a non-sufficient-funds (NSF) fee and return the consumer's check unpaid to the merchant. The consumer might be charged a second fee by the merchant.

In some cases, banks will cover an overdraft at their discretion for their preferred customers, for which they charge an overdraft fee. Bank managers usually make the decision on which customers' checks will bounce and incur the NSF fee and which checks will be covered and charged the overdraft fee. Bank officials have the discretion to forgive overdraft fees for individual consumers.

Both NSF and overdraft fees are hefty, and have been rising for the past several years. In 2001, the average NSF fee was $20.75, up from $17 in 1997, and the average overdraft fee was $20.50, up from $16.50 in 1997. NSF and overdraft fees have increased at a rate substantially greater than the increase in the Consumer Price Index for the same period. Banks will earn $30 billion in ATM, bounced check, and overdraft fees this year, up 14% from 2001.

These fees far exceed the cost to the bank for bouncing a check. In 1998, a CFA report noted that it only costs banks up to $1.50 to bounce a check. The report quoted industry data that estimates banks incur average transaction costs of $.50 to $1.50 to process bounced checks. Based on NSF fees charged in 1997, bounced check fees ranged from 11 to 32 times the cost of handling NSF checks.

Banks justify NSF and overdraft fees that run much more than it costs the bank to handle the checks as providing a deterrent to mismanagement of the account. NSF and

overdraft fees are considered punishment for doing something that may be considered a criminal violation (deliberately writing checks without funds on deposit to cover them).

CFA's report estimated that banks generated more than $5.6 billion in annual revenue and $5.2 billion in annual profits from bounced checks. The report also noted that some banks use a variety of devices to increase income from NSF checks, including changing the order in which checks clear the bank. By programming bank computers to clear the largest checks first, a bank is able to bounce a larger number of smaller checks than it would if the smallest checks were cleared first.

5. Comparison with Overdraft Lines of Credit and Other Contractual Plans

In contrast to bounce protection, banks offer a much more reasonable credit product to the customers to avoid bounced checks - overdraft lines of credit. Banks also offer programs where overdrafts are covered by the consumer's credit card or by transfers from a savings account. These products offer a better value to consumers, as well as including Annual Percentage Rate disclosures for the credit products so that consumers can shop around and know what they are getting.

Interest rates for overdraft lines of credit are generally around 18% APR. Over 80% of banks offer these lines of credit. Less than half of these banks also charge an annual fee of about $15 to $20.

A customer who applies for overdraft line of credit must meet credit-worthiness criteria. Relatively few account holders apply for and qualify for contractual overdraft protection. One of the banking consultants who offers bounce protection explicitly stated why banks do not promote these lines of credit and prefer bounce protection: traditional overdraft programs are not as profitable (because they do not charge astronomical fees), and that customers who bounce checks are reluctant to apply for overdraft protection and may not qualify.

6. Bounce Protection Plans Are Designed To Boost Bank Income By Encouraging Consumers to Overdraw Their Accounts

The consultants who promote bounce protection repeatedly emphasize increase in fee income as the major selling point. For example, Pinnacle's website promises banks that will raise overdraft fee income by "100%, 200%, 300% or more!" John M. Floyd Associates claims that participating financial institutions will increase its NSF income anywhere from 50 to 300 percent. 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.

The underlying reason why fee income increases can be nothing other than an increase in the number of overdrawn checks. The bounce protection industry must know they are encouraging consumers to write bad checks. They are deliberately encouraging consumers to commit an irresponsible and sometimes arguably criminal act. Consultants urge bankers to stop thinking of "overdraft" as a naughty word and start thinking that

overdrafts are a good thing.

Banking consultant BSG provides additional advice to bankers on how to encourage consumers to overdraft. BSG recommends increasing overdraft income by using reverse order check clearing, encouraging overdrafters to overdraft more frequently and attracting chronic overdrafters. In one of its presentations posted to its website, BSG describes how banks are doubling NSF income by currying relationships with overdraft customers, including sending a "thank you" letter rather than a dunning letter for overdrafts; making NSF "OK" by allowing debit card and ATM overdrafts; and being friendly to overdraft customers."

John M. Floyd Associates points out that a bank account customer who writes an average of only one NSF check per month has the equivalent earnings value of an account holder who maintains a $12,000 average balance. Floyd advises that, since there are so many more consumers who are likely to take advantage of bounce protection programs than there are "affluent" account holders, banks should take care of and value these customers.

Furthermore, taking care of chronic overdrafters appears to mean feeding their overdraft habit even when the bank knows the consumer is repeatedly overdrawing his account, may be getting into trouble, or even abusing overdrafts. Consider this example from a consumer who conducted an experiment with his checking account:

> AB is a customer of a major bank, where his account includes bounce protection of $500. AB withdraws $100 from his bank account, but only has $80 in the account. His ATM receipt shows a balance of minus $20 after the transaction. A few days later, AB receives a letter from his bank that he is overdrawn by $40, including a $20 bounce protection fee.
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> AB does not pay the $40, but continues to withdraw cash until he reaches his $500 limit. He does not pay the overdrawn amount and receives more letters from his bank, which get sterner. His bounce protection is terminated. A few days later, AB pays the overdrawn amount (including fees). Next month, AB receives his bank statement, which shows that now only has his bounce protection been restored, but his limit has been *increased* to $1,000.

7. Impact on Consumers

It appears that bounce protection programs do not set controls on how often a consumer can overdraw the account, do not set cooling off periods between overdrafts, do not set a limit on the number of overdrafts used in a month as long as the "bounce protection" limit is not exceeded, and do not verify that an account is still in good standing before approving overdrafts after the account is originally admitted to the program. In other words, there are no protections in place to prevent consumers from becoming mired in perpetual debt or cascading bounce protection fees. We know of no systematic bank programs to identify chronic users of bounce protection plans, attempt to provide counseling, or provide information about more affordable credit products. The Office of

the Comptroller of the Currency expressed concerns about the lack of safeguards in one overdraft plan the OCC reviewed.

This concern is not a theoretical one - repeated overdrafts under bounce protection can place a consumer into difficult financial circumstances. For example, consider the consumers who overdrew their accounts and were hit with bounce protection fees in the a recent Ninth Circuit case:

> BB is a physically disabled woman with severe depression after the death of her husband of 35 years. Her sole income was $898 per month in Social Security widow and disability benefits, which were direct deposited to her bank account at Washington Mutual. BB's bank account had a bounce protection limit of $1,000. While BB was in the hospital for hip replacement surgery after a fall, her daughter wrote forged checks on BB's account and made unauthorized charges on BB's debit card. Washington Mutual took one and a half months worth of BB's Social Security benefits to pay for the overdrafts, including $450 in overdraft fees. As a result, BB was left with no money to pay her rent or food. She was evicted from her apartment and forced to rely on a neighbor for food.
>
> LL is a mentally disabled man with bi-polar disorder who lives on Social Security Disability benefits of $752 per month. His benefits were direct deposited into his Washington Mutual account, with a bounce protection limit of $900. One of the symptoms of his manic phase was compulsive spending. He overdrew his account twenty times in a one week period, and was assessed an $18 bounce protection fee each time. When LL used his debit card to make a $3.23 purchase, he was assessed an $18 fee. LL overdrew his account by over $1,600 (despite a bounce protection limit of $900). Washington Mutual did not attempt to stop LL or inquire into this erratic account activity - the activity stopped when LL was admitted into a psychiatric facility. Instead, WAMU simply took LL's Social Security Disability benefits for the next month, which left LL penniless when he was discharged from the psychiatric facility.

Another example comes from the facts in a West Virginia lawsuit against City National Bank:

> SJ is 71 year old woman who lives alone and whose sole source of income is Social Security benefits of $565 a month. She has a checking account with City National Bank. Her account has a bounce protection plan with something called a sustained overdraft fee, in which the bank imposes a $5 per calendar day fee for every day an account is in overdraft. SJ forgot to record a check in her check register. The next check she wrote was for $124, but she had a balance of only $88.21. For an overdraft of $35.79, the bank charged a $30 NSF fee and, the next day, started charging her $5 a day for each day the account remained in negative balance. SJ did not find out about the overdraft until **11 days later** when a letter arrived from the bank. SJ immediately deposited enough cash to cover the overdraft and fees. For a $35.79 loan of less than 2 weeks, the bank assessed bounce protection charges for $75, which was one-eight of SJ's monthly income.

SJ does not even recall receiving the notice that the bank allegedly sent stating it would begin imposing a $5 per day overdraft fee.

Bank executives freely admit that their targets for bounce protection fees are low- to moderate- income consumers who live on a fixed income. One bank consultant conceded that these consumers are more likely to use bounce protection, stating:

> areas of high unemployment, higher unemployment, you typically have more activity…If you happen to be a bank that's on a military post, you're probably doing twice as much activity as any other bank.

Another banker has said that "It's for the person who accidentally overdraws the account - the blue collar, workaday folk that live from paycheck to paycheck and cannot afford the hassle of bouncing a check." These are also the same people, of course, who cannot afford to be paying excessive loan fees on a regular basis. Banks deliberately target low- and moderate-income consumers by placing offices in supermarkets with a middle to down market clientele.

Furthermore, it is often a small group of vulnerable consumers that make up most of the bank's newly increased profits from bounce protection. One bank consultant revealed that 80% of a bank's overdraft income comes from about the same 15 to 25% of their customer base. Another consultant estimated 4% of customers pay half the fees, as much as $2,000 per customer annually. This group of probably disproportionately low- to moderate- income consumers is carrying the weight of the huge run-up in overdraft income for banks.

8. The Banks' Competition for Payday Loan Business

Payday loan companies make very short term loans to bank account holders who don't have sufficient funds in their bank accounts. Payday loans cost on average 470% APR and involve loans based on personal checks held for future deposit. There has been severe criticism of payday loans by consumer groups. The payday loan industry exploded onto the market in the mid-90s, at about the same time bank consultants started marketing bounce protection plans.

Banking consultants have been very specific that bounce protection programs are the banking industry's answer to payday loans. Several consultants explicitly pitch their products as a competitive alternative to payday loans.

> Consultant Banking Exchange Technologies states: "Currently one of the fastest growing segments in the financial services industry is the short term loan, or check cashing outlets. This [bounce protection] system negates bank customers from seeking these services outside of their bank."

> Consultant BSG states: "Some bank customers are driven by convenience and the need for short term funds. They are willing to pay for the privilege of spending money they don't quite have yet. Somehow, these customers will get the money

> they need. Wary of the uncertain consequences of overdrawing their checking account, many pay routine bills late and incur late fees, many also choose to patronize payday loan outfits, cash checking services and the like. The result? Your customers are paying big fees to meet their simple banking needs, but not to you. With the OverdraftHonor program, you can give your customers an alternative, one that saves them money while dramatically increasing your fee income."

> A representative of consultant BSG defended its bounce protection plan in the pages of the American Banker in the "the best way for banks to assure customers do not use unsavory services (such as payday-loan companies) is to offer customers a more attractive alternative."

> In an "industry brief" issued in 2000, Raymond James & Associates described the operations of payday lenders in comparison to banks that charge high NSF fees and bounce checks for customers who overdraw accounts. The brief concludes that "if the bank priced appropriately and developed new short-term lending products, it could provide the funds needed to drive the mortgage companies, rental agents, utilities and others out of the market. The banks could capture their profits."

Yet in some ways bounce protection is even worse than the scourge of payday loans. The APRs for bounce protection can be several times that of payday loans, which are already grossly usurious. Furthermore, at least payday lenders are required to provide TIL disclosures.

Consumers are likely to incur higher dollar amounts with bounce protection fees than payday loans, shocking as that may be. A typical payday loan consumer may pay $50 for a $400 loan of 2 weeks, which is already an excessive fee. A consumer who borrows that much from a bounce protection plan faces a real possibility of paying more, because the consumer will have accessed the credit using multiple payment methods and incurring multiple fees. For example, the consumer might have overdrawn $400 by writing 3 checks for $100, withdrawing $100 from an ATM, and using her debit card to pay $100. Since she has made 5 transactions that overdrew her account, she will be charged 5 times for probably at least $20 - making that $100 in fees or twice the payday loan fee.

Reforms

With bounce protection, the banking industry has entered into the fringe lending market, promoting an extremely high-cost credit product to low- and moderate-income consumers. Banks should not be permitted to this. The following reforms, which have been recommended to the Federal Reserve Board, would prevent the abuses of bounce protection plans.

> Banks should be prohibited from imposing bounce protection plans on consumers without their affirmative consent.

Truth in Lending disclosures should be required for bounce protection, including per item and per days fees. Disclosures should be made at ATMs when consumers withdraw cash.

Banks should be prohibited from stating that bounce protection is "discretionary" when they have advertised, represented or implied that consumers should have the expectation bounce protection will cover overdrafts.

Banks should be prohibited from advertising or promoting any plan that encourages consumers to write NSF checks or take other steps that might have criminal consequences.

Banks should be prohibited from promoting bounce protection plans without informing consumers of other less expensive alternatives.

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

Attachment 1

Consultants That Market Bounce Protection Plans

The following is specific information regarding each of the eight bank consultants that market bounce protection to banks.

Strunk & Associates, L. P., located in Houston, TX and Parkville, MO, describes itself as "a financial institution advisory service." Strunk is reported to have 540 banks who use its bounce protection plan as of November 2002, according to a Newsweek column. Strunk has an alliance with a subsidiary of America's Community Bankers, the thrift trade group, to provide its Overdraft Privilege Program to ACB members.

John M. Floyd, is based in Houston, TX, sells a plan called "Overdraft Privilege." The company states that it provides bounce protection services to 1400 financial institutions. John M. Floyd also emphasizes that its program is coupled with Free Checking Programs.

BSG, LLC, formerly Bank Strategy Group, is based in Louisville, KY. It markets "OverdraftHonor" product to banks. BSG tells bankers that many banks using OverdraftHonor have achieved growth of 70 to 100 percent in overdraft fee income and sets it fee based on the incremental pre-tax profit it generates for banks.

Pinnacle Financial Strategies from Houston, TX, markets its program as trade-marked brands "Bounce Protection," "No Bounce Advantage," and "No Return Benefit." Pinnacle claims more than 200 banks have implemented its overdraft protection program.

Moebs Services markets a "No-Bounce" program. Moebs claims the highest overdraft limits, bulletproof compliance, highly controlled and very low check losses, and a No-Bounce and free checking program that can be used together or separately.

Alex Sheshunoff Management Services, L.P., based in Austin, TX, markets "Platinum Overdraft." The Sheshunoff software includes these features: Detailed customer screen, record and history for contact management; complete history on all overdrawn customers for analysis and data mining; automatic tracking of new start loans, recoveries, and charge-offs; automatic electronic reporting to Chex Systems; tracking of every letter, phone call or activity with a customer, and scripts for easy training.

IFS Impact Financial Services, based in Little Rock, Arkansas, markets Free Checking with Overdraft Privilege to banks. Its only business is NSF Fee Income Enhancement, and includes Automated Overdraft Privilege, Free Checking, and "Fresh Start" Collection Plan.

Haberfield Associates, from Lincoln, Nebraska, has more than 300 client banks in 49 states who offer free checking with overdraft "privileges."

This Interpretive Letter is also available on the OCC website at
http://www.occ.treas.gov/interp/sep01/int914.pdf

Comptroller of the Currency Administrator of National Banks

Washington, DC 20219

Interpretive Letter #914

August 3, 2001

September 2001

15 USC 1691
12 CFR 215
12 CFR 226
SBJ CONS

Subject: [***3rd Party***]
[***Program***]

Dear [ ]:

This letter responds to your correspondence with Brenda Curry, District Counsel of our Southeastern District Office, which was referred to our Washington Headquarters office. You had formally requested a program evaluation/comfort letter in connection with ***[an overdraft protection program]*** (Program) offered by [***3rd Party***].

We have reviewed the materials that were submitted along with your letter, and we are unable to provide such a letter. In our view, the Program presents a number of concerns, which we summarize below.

Compliance Issues

Truth in Lending/Regulation Z

An overdraft would be "credit," as defined by the Truth in Lending Act and Regulation Z. 15 U.S.C. § 1602(e). The key issue under Regulation Z, however, is whether the fee charged in connection with the overdraft is a "finance charge." The answer would depend on:

- Whether a nonsufficient funds (NSF) fee charged by the bank is the same whether the NSF check is paid or returned; and
- Whether there is an agreement between the bank and the accountholder pursuant to which the bank will pay the accountholder's NSF checks and impose

a fee for doing so.

See 12 C.F.R. §§ 226.4(b)(2) and (c)(3).

If the fee were determined to be a finance charge, the bank would have to make the disclosures required in Regulation Z for open-end credit. *See, e.g.,* 12 C.F.R. §§ 226.5 and 226.6.

Truth in Savings/Regulation DD

Certain fees must be disclosed in connection with a deposit account. At the time an account is opened, the disclosures must include the amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed. 12 C.F.R. § 230.4 (b)(4).

If the Program were added to an already existing deposit account, advance notice to the accountholder may be required. A bank must give advance notice (at least 30 days before the change) to affected customers of any change in a term that was required to be disclosed under § 230.4(b) (which includes fees imposed in connection with the account) if the change may reduce the annual percentage yield or adversely affect the consumer. 12 C.F.R. § 230.5(a)(1).

Electronic Fund Transfer Act/Regulation E

In connection with the *[ ]* Repayment Agreement, the customer is urged to repay the amount of the unpaid overdraft over time through preauthorized transfers from his/her checking account. A participating bank would need to comply with the Regulation E requirements for preauthorized transfers. 12 C.F.R. § 205.10(b).

Equal Credit Opportunity Act/Regulation B

An "overdraft" would be "credit" under Regulation B. *See* 12 C.F.R. § 202.2(e). A memorandum from ***[A]*** of ***[3rd Party]*** to ***[B]***, dated June 10, 2000, provided criteria for selecting "ineligible (excluded) accounts," i.e., those accounts that are not eligible for the Program. Among those accounts are: "Accounts which, *in reviewing officer's judgment,* should *not receive* the automated overdraft payment service, such as (See sample memo): Not creditworthy or questionable financial condition." (Emphasis in original.)

The materials do not appear to provide any indication of standards for the reviewing officer's determination. When a decision is left to bank personnel's discretion, there may be a potential for disparate treatment in violation of ECOA and Regulation B. *See* 12 C.F.R. § 202.4.

Federal Trade Commission Act

The Federal Trade Commission Act prohibits deceptive acts or practices, including representations or omissions that are likely to mislead reasonable consumers and, thus, affect a consumer's choice or conduct regarding a product. *See* 15 U.S.C. § 45(a)(1) and the FTC Policy Statement on Deception (October 14, 1983).

The marketing materials for the Program send a mixed message as to whether the bank is committing to pay overdrafts as long as the account meets the stated qualifications for the Program and also raise numerous ambiguities about or overstate the benefits of the Program:

- In a number of places the materials make such statements as "we *will* pay your checks ... if you maintain your account in good standing." The back of the marketing materials, however, states that "we may refuse to pay an overdraft for you" and that this is being done as a "non-contractual courtesy."

- The materials give the wrong impression about the scope of the protection offered by the program and oversell its benefits. Claims of "no more charges from retailers for insufficient checks," "make a mistake -- you're covered," and "write a check or use an ATM for more than you have in the bank -- you're covered" are broad statements given the limitations placed on the program.

- The materials may leave the customer with the wrong impression about what the actual overdraft limits are. For instance, with respect to an account to which a $500 limit is applicable, the bank would not, under the program, pay an overdraft that exceeded $480 because the $20 NSF fee, would cause the overdraft to exceed the $500 limit.

- The requirement that the account need only be brought to a positive balance once every 30 days also may be illusory. We note that the materials provide that "The amount of any overdrafts plus our Non-Sufficient Funds and/or Overdraft (NSF/OD) Charge(s) that you owe us shall be due and payable upon demand."

Regulation O

Overdrafts are considered extensions of credit for purposes of Regulation O. 12 C.F.R. § 215.3(a)(2). If, as some of the materials appear to indicate, a bank also makes this product available to certain bank insiders, issues would appear to arise under Regulation O governing extensions of credit to bank insiders.

Supervisory Concerns

Your characterization of the product as something other than lending raises supervisory issues:

- It is possible that overdrafts would be paid for customers who would not qualify for

loans under the prudent underwriting standards that the bank should use for all of its extensions of credit. This could increase a bank's credit risk profile (e.g., higher delinquency and loss rates) by extending credit to borrowers that may not have normally qualified for payment of overdrafts or overdraft protection;

- Given the loss history of bank overdraft programs, bank management must develop reasonable loss recognition guidelines and establish loan loss reserve methodologies to ensure timely loss recognition and estimated loss coverage.

- Although the submitted material indicates a measuring and monitoring process (infers MIS reporting), it is unclear what this entails, including the types and quality of information provided to a bank to assess credit risk performance on a periodic basis. Banks must have appropriate MIS reporting established.

- Banks also need to take great care in entering into contracts with third party vendors. This raises a variety of supervisory concerns that banks should address before entering into an arrangement with a vendor in connection with the potential purchase of products including:

- Most banks have software already capable of overdraft protection without incurring the high up-front and ongoing costs of the Program. Consequently, the benefits of the Program are not readily evident, in that a bank could otherwise achieve the same results if it implemented and marketed its existing capabilities;

  - It appears that the arrangement a bank enters with the vendor to participate in the Program is devised in such a manner that only the bank is subject to the credit and reputation risk, while the vendor shares the benefits, i.e., the income;

- Banks are expected to conduct due diligence reviews of vendors. This includes initial and ongoing reviews of the financial information of any vendor. These reviews are necessary to ensure that the company can fulfill the representations as outlined in the contract. Requirements for the timing and quality of financial information should be set forth in the contract;

- The sample contract indicates a termination clause that appears to prohibit or severely restrict the contracting bank's ability to terminate once the program is initiated. Only the vendor has control of termination, and the only termination consideration is if the 150% fee income profitability goal is not achieved. This one-sided termination clause is potentially detrimental for the bank from a reputation, financial, and strategic risk perspective. Under the contract, the bank has no recourse if it becomes dissatisfied for a variety of reasons such as customer satisfaction/bank reputation and credit risk issues (e.g., 50% of the customers complain or 15% delinquency rate).

Policy Issues

The Program is designed to increase fee income by encouraging customers to write NSF

checks. Although the Program may be valuable to customers who might inadvertently or infrequently write an NSF check, banks participating in the Program will, in essence, attempt to entice their customers to write NSF checks more frequently and on purpose in order to generate fee income. *This use of the Program could promote poor fiscal responsibility on the part of some consumers*.

In this regard, we note the complete lack of consumer safeguards built into the program:

- in some circumstances the charges assessed on customers may be just as burdensome as those imposed on borrowers utilizing other types of high interest rate credit;

- an unlimited number of overdraft charges could be levied during a 30-day period as long as the consumer does not exceed the dollar amount limitation on overdrafts;

- no cooling off period following the repayment of overdraft amounts during which no overdrafts would be paid, thus increasing the likelihood that a customer would consciously resort to use of this product to pay for ordinary day-to-day expenses;

- no grace period (for instance, 24 hours) during which the customer can reimburse the bank without incurring the NSF charge after receiving notice that a check was paid;

- no effort by banks offering this program to identify customers who are writing overdraft checks regularly as a means of meeting regular obligations in order to attempt to serve their needs through more economical alternatives; and

- no effort by banks offering the program to inform customers generally of available alternatives for short-term consumer borrowing, explain to customers the costs and advantages of various alternatives to the program, or identify for customers the risks and problems in relying on this product and the consequences of abuse.

Thank you for the opportunity to evaluate the Program. We hope that this information is useful to you.

Sincerely,

-signed-

Daniel P. Stipano
Deputy Chief Counsel