Consumer Federation of America

Abusive Lending Practices by Smaller Banks and Thrifts

Over the years, many smaller banks and thrifts have adopted responsible, fair and sustainable mortgage lending practices. Small banks and thrifts that offer trustworthy credit and payment products should face a lower regulatory burden from the Consumer Financial Protection Agency (CFPA) and should therefore have nothing to fear from this new agency. However, some smaller banks and thrifts have been on the cutting edge of a number of abusive lending practices that are harmful to consumers and must be addressed by the CFPA.

<u>Bank Overdraft Loans:</u>
More than 75% of state chartered banks surveyed by the FDIC automatically enrolled their customers in high-cost overdraft loan programs without consumers' consent. Some of these banks even deny consumers the ability to opt out of banks paying overdrafts and charging steep fees. Overdraft and insufficient funds fees are a major source of revenue for banks, including the smaller state banks supervised by the FDIC. These fees in 2006 represented 75% of the $2.66 billion in service charges on deposit accounts at these FDIC state banks.

According to a 2008 FDIC report based on a survey of 462 FDIC-supervised state banks:

- 75.1% of the mostly small banks surveyed automatically enrolled customers in automated overdraft programs (some also denying consumers the ability to opt out of having overdrafts paid for a fee).
- Fees ranged from $10 to $38; the median fee was $27.
- About 1/4 of these state banks added sustained overdraft fees when consumers did not repay the overdraft in just days.
- 1/4 of banks surveyed and over half of the largest surveyed banks processed overdraft transactions largest to smallest, thus increasing the number of overdrafts.

<u>High Cost Refund Anticipation Loans (RALs)</u>
Smaller banks have been leaders in facilitating high-cost refund anticipation loans. In 2009, with all fees included, the annual percentage rate for RALs at small banks was 134% - 187% for a $3,000 loan repaid by direct deposit of a tax refund and/or Earned Income Tax Credits.[1]
Small banks also charge more for these RALs than do the large banks. For example:
For the 2009 tax season, a typical $3,000 refund anticipation loan cost:

- Large Banks:
  - $62.14 at H&R Block through HSBC;
  - $62 through independent preparers who used JPMorgan Chase;
- Small Banks:
  - $110.45 at Republic Bank & Trust;

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[1] Chi Chi Wu and Jean Ann Fox, "Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Workers at Risk," National Consumer Law Center and Consumer Federation of America, February 2009, page 10.

- $104.95 at Santa Barbara Bank & Trust which also permits its independent tax preparer partners to charge an additional $40 fee

Rent-A-Bank Payday Lending
For years, over a dozen small national and state-chartered banks and thrifts "rented" their charters to enable payday lenders to evade state usury and small loan protections. By the time bank regulators deprived payday lenders of willing bank partners, state consumer protections had been undermined.

Bank Payday Lending
Although rent-a-bank payday lending was eventually halted by federal bank regulatory actions, banks are still using their preemptive powers to directly make look-alike loans.

MetaBank, a federally chartered savings association headquartered in South Dakota, offers the iAdvance line of credit on prepaid cards, including payroll cards. The loan operates exactly like a payday loan:

- Small, short term credit with a flat fee ($25 per $200);
- Borrower must have a regular paycheck (direct deposit of wages or government benefits onto the prepaid card);
- Disclosed APR is 150%, assuming that the loan is outstanding for the full 30 day statement cycle.
- APR is actually 650% if the loan is taken out a week before payday.

Third-Party Direct Deposit Arrangements with Check Cashers and Loan Companies
The 1996 law requiring distribution of federal benefits by direct deposit had the unintended side effect of exposing unbanked Social Security, SSI, VA, and federal pension recipients to check cashers and loan companies that offer expensive, second-class direct deposit accounts. Recipients are charged steep fees for these direct deposit arrangements through small banks and pay exorbitant interest rates for loans based on future receipt of exempt federal funds.

Subprime "Fee-Harvester" Credit Cards
Smaller banks issue high fee, low limit "fee-harvester" credit cards to consumers with impaired credit. These cards are marketed to the most vulnerable consumers and come with loaded high fees that use up most of the card's capacity, leaving consumers with minimal credit at an exorbitant price.

- A MasterCard issued by CorTrust exemplifies the abuses of fee-harvester cards:
  - $**250 credit limit quickly consumed by**:
    - $119 Acceptance Fee,
    - $50 annual fee,
    - $6 per month Participation Fee,
    - **Leaving just $75 in total usable credit.**

- A First Bank of Delaware card issued by Continental Finance in 2007 started with:
  - **$300 credit limit quickly consumed by:**
    - $99 account set-up fee,
    - $89 Participation Fee
    - $49 Annual Fee
    - $10 per month in Account Maintenance fees.[2]
    - **Leaving just $53 in usable credit**

[2]Rick Jurgens and Chi Chi Wu, National Consumer Law Center, "Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers," November 2007, Pages 1, 6.