PEW HEALTH GROUP

September 21, 2011

Mr. Rajeev Date
Special Advisor to the Secretary of the Treasury
Consumer Financial Protection Bureau
1801 L Street, NW
Washington, DC 20036

RE: Regulatory Authority and Priorities of the Consumer Financial Protection Bureau

Dear Mr. Date,

We write to ask that the Consumer Financial Protection Bureau (CFPB) act quickly to ensure that consumers are protected from unfair banking practices and are provided important information about their accounts.[1] There are certainly many endeavors that require the attention of the CFPB, but checking accounts, a product that 9 out of 10 American households use, should be a top priority.[2] Research has conclusively shown that hidden bank fees and practices as well as the lack of clear disclosures can be harmful to consumers.[3] The undersigned organizations are all committed to reasonable regulations that protect consumers and allow for competition in the consumer finance industry. We ask that the CFPB do the following:

- Require information on important checking account terms to be disclosed in a one-page "Consumer Choice Box";
- Require complete disclosure of all overdraft options;
- Require reasonable and proportional overdraft fees;
- Require the posting of deposits and withdrawals in a neutral manner; and
- Examine the prevalence of dispute resolution clauses in checking account agreements and the existence of fee shifting provisions that require the accountholder to pay at least a portion of the bank's costs when a dispute occurs.

These are important policy changes that have wide public support and that the CFPB can and should consider as priorities in the early stages of its work.[4] The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) provided the CFPB with rulemaking authority that should be used to carry out these policy recommendations. Because the CFPB has the authority to implement the Truth in Savings Act (TISA) and Electronic Fund Transfer Act (EFTA) and has new authority to regulate abusive practices and limit mandatory arbitration, it could achieve all of these important goals.[5]

Disclosure Box

TISA requires banks to offer a schedule of specified terms and conditions for all deposit accounts prior to account opening. Such disclosures must be available on demand to consumers so that they can "understand and compare accounts."[6] TISA provides authority to issue regulations, enforce its requirements and issue model forms for disclosure.[7] Similarly, EFTA requires financial institutions to disclose the terms and conditions when a consumer enrolls in electronic fund transfer services, such as an ATM or debit card.[8] In addition, it also allows regulators to issue rules, enforce its requirements and issue model clauses to facilitate compliance.[9]

These statutes provide ample authority for the CFPB to require financial institutions to supply a concise table of important terms and fees to potential customers on demand, at account opening and online. When the Federal Reserve had authority to write rules and issue model forms regarding disclosure, it used that authority to require disclosures of a variety of fees and also mandated specific disclosures for overdrafts, separate from other documents.[10] Unfortunately, these rules did not provide for effective disclosure of terms and fees. The Pew Health Group's research found that the median length of disclosures at the ten largest banks is 111 pages.[11]

The CFPB should require a one-page form that would provide accountholders with important fees and terms. U.S. PIRG has also recommended that mandatory in-person TISA fee disclosures be extended to bank websites. This regulatory change would strengthen disclosure requirements so customers are given all important information about their accounts up front and would enable consumers to shop around for the products most suitable to their needs. Because the rulemaking authority of TISA and EFTA pass over to the CFPB whether or not a director is confirmed, these rules could be implemented immediately.[12] Pew has developed a consumer-tested disclosure box that could be used as a model for the CFPB's efforts.

Full Disclosure of Overdraft Options

Under the same authority that the CFPB could use to require a disclosure box, it could also require full disclosure of consumers' overdraft options prior to opt-in and as part of the aforementioned disclosure box. Last year, the Federal Reserve instituted rules requiring a separate disclosure form and opt-in before a financial institution may enroll a consumer in an overdraft penalty plan.[13] Unfortunately, the Fed's model opt-in form does not clearly lay out all of a consumer's overdraft options. Our recommendation would require that the CFPB amend these regulations to ensure that overdraft policy disclosures are clear and comprehensive. A slight modification to these rules would allow the CFPB to issue a new model form that would achieve more effective disclosure of overdraft options. Like the disclosure box discussed above, this regulation could be implemented immediately.

Reasonable and Proportional Overdraft Fees

The CFPB has new rulemaking authority to regulate unfair, deceptive, or abusive acts or practices (UDAAP) in consumer financial products and services for all financial institutions and related service providers.[14] The CFPB could use its power under UDAAP to implement regulations limiting overdraft fees. The following subsections explore the possibility of using the unfair or abusive prongs to implement reasonable and proportional overdraft penalty fees. We believe that this is exactly what the CFPB should be regulating with its UDAAP authority.

Unfair

To declare an act or practice unfair, the CFPB must find that it meets three criteria. First, there must be a reasonable basis to conclude that the act or practice causes or is likely to cause substantial injury to consumers.[15] A substantial injury can include a relatively small monetary loss to a large number of consumers.[16] Second, the injury must not be reasonably avoidable by consumers.[17] Here, the question is whether consumers are able to effectively make their own decisions about whether to incur the injury.[18] In addition to having a choice, consumers must also not be deprived of the information necessary to make their own conclusions.[19] Third, the injury cannot be outweighed by countervailing benefits to consumers or competition.[20] This balancing test includes the costs of imposing a remedy and the benefits that consumers enjoy as a result of the practice.[21] Additionally, established public policies—those that are embodied in a statute, regulation, or judicial decision—may be considered but may not be a primary basis for unfairness determinations.[22]

Excessive overdraft fees could be declared unfair using this test. The first requirement is a substantial injury to consumers. Overdraft fees will total an estimated $38 billion in 2011.[23] By any reasonable measure, this is excessive and therefore is a substantial injury to accountholders.

The second prong of the test is whether a consumer can freely make a decision to incur the injury. If consumers are overdrawing their accounts and incurring large fees because they have no other means of accessing funds, then they cannot be said to be acting "freely." A person would not choose to incur a $35 fee in order to gain access to a relatively small amount of capital unless it was the only available option. A small number of individuals incur the majority of overdraft fees, often overdrawing their accounts 10 or more times per calendar year.[24] This favors the conclusion that consumers are using overdraft fees as a very costly form of credit because they have no better alternatives, and excessive overdraft fees take advantage of these consumers. This conclusion is buttressed by the marketing materials commonly used by financial institutions to enroll customers into costly overdraft services. These materials often elicit fears of not having any access to funds without overdraft services.[25]

The last part of the test is weighing the benefits to consumers or competition against the injury. Overdraft fees do not help consumers or competition. While overdrafts do provide access to funds, they have extremely high interest rates and do not provide a long-term credit solution. In addition, the prices of overdraft penalty fees seem out of line with the cost of providing them.

Abusive

The abusive prong is a new source for UDAAP rulemaking authority granted to the CFPB.[26] Abusiveness is subject to two elements that are delineated in the Dodd-Frank Act.[27] The act or practice must either:

1. Materially interfere with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
2. Take unreasonable advantage of
    a. a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
    b. the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
    c. the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[28]

Looking at the statutory language, exorbitant overdraft fees could be declared abusive using any of the three clauses in the second paragraph. Subsection (c) is implicated because consumers could easily believe a financial institution's marketing and account disclosures that claim overdraft protection is a useful tool that helps consumers, not an extremely costly credit product that forthcoming Pew research demonstrates often leads to account closures. Consumers might believe that their banks would not offer a service that leads to them losing their accounts. This fact also bolsters the applicability of subsection (b). Accountholders who incur a large number of overdraft fees can be caught in a cycle of overdrafts if they are unable to repay the overdrafts plus the fees and their other living expenses.

Posting Order

The CFPB could use its power to regulate UDAAP to rein in the practice of reordering withdrawals and posting them from highest to lowest dollar amount. This practice could be regulated under the unfair or the abusive prongs of UDAAP; it could also possibly be declared deceptive under that test. The same legal tests that would be used to declare high overdraft fees unfair or abusive would be used for this practice; these are explained in the previous section. The following subsections apply the standards to a prohibition on the high-to-low reordering of transactions. The legal requirements for the deceptive prong are outlined in this section as well.

Unfair

The practice of reordering transactions from highest to lowest causes substantial injury to consumers. In 2010, the court in *Gutierrez v. Wells Fargo Bank* found that accountholders were unfairly charged $203 million due to high-to-low reordering.[29] If this amount were not enough on its own to constitute a "substantial injury," it should be noted that it only encompasses Wells Fargo customers in the state of California, a small portion of accountholders across the country.[30]

It can be very difficult for consumers to avoid the practice of reordering transactions even if they understand it. First, the practice has been widely used in the past, leading to a pending legal case involving 30 of the largest banks in America.[31] Second, banks may change their processes at any time without notifying consumers. This makes it impossible for a consumer to avoid being susceptible to high-to-low reprocessing.

The final test, whether there are benefits to consumers or competition, again favors prohibiting high-to-low reordering of withdrawals. For a consumer, the lower number of fees associated with a neutral posing order is a better alternative. In the case of an authorized debit transaction, the overdraft fee is connected to a "must pay" item, so the posting order only affects how many fees a customer incurs, as the item must be paid by the bank. "Must pay" items, which are transactions the bank has authorized and is therefore obligated to cover, cannot be returned unpaid. In addition, even items that are not "must pay" items are routinely paid through automated overdraft services. This means that there is often no difference between high-to-low and other processing orders in terms of which items are paid by the bank. The only difference is the number of fees the accountholder must pay.

The only scenario in which the order of withdrawals will have an effect on the accountholder other than the number of fees incurred is when the bank pays certain items and returns other items unpaid. In this case, it is impossible to tell which item a consumer would actually want to have paid first. The accountholder may want the higher priced item paid, but he or she could also prefer the lower priced item be paid first. Therefore, even in these cases it is unclear whether there would be any benefit to the customer. On the other hand, the detriment of paying the highest transactions first is worse than a neutral posting order because more fees are accrued.

Because all three prongs of the unfair test are easily met, a prohibition of high-to-low processing of withdrawals is within the power of the CFPB. In addition, posting high-to-low has been declared unfair by a federal court in California.[32] This further justifies the CFPB to take action to end this practice as there is established public policy against it.

Deceptive

Standards for deception are not codified, but guidance from the Federal Trade Commission (FTC) has previously been used by the Federal Reserve to define the term.[33] In general, a deceptive act or practice requires a representation or omission of material information that is likely to mislead consumers acting reasonably under the circumstances.[34] This standard is subjective in that it is based on the consumers who are targeted by the act or practice.[35] The FTC considers the overall net impression created by an act or practice.[36] A representation can be deceptive even if other non-deceptive interpretations are possible, so long as one reasonable interpretation is misleading.[37]

It is questionable whether the disclosure of high-to-low posting, no matter how clear or prominent, would save the practice from being deceptive under the standard currently in use. Reordering is a complicated process that can cause a person to overdraw his or her account multiple times by virtue of a single transaction. While overdraft "protection" is marketed as a means of ensuring that transactions are approved, reordering is designed to ensure that each overdraft carries with it the maximum number of penalties. The fact that Wells Fargo's own expert witness in the *Gutierrez* case testified that customers cannot keep track of their balances further illustrates this point.[38]

Abusive

Like the high cost of overdrafts, high-to-low posting order could be regulated under any of the abusive standards set forth in the Dodd-Frank Act. In particular, section 1031(d)(2)(A) is on point for this practice, which says that banks cannot take unreasonable advantage of a consumer's lack of understanding of the risk or cost of a financial product. A scenario in which one transaction turns into hundreds of dollars in overdraft fees is not something most consumers would understand absent falling victim to the practice of high-to-low processing of withdrawals. Reordering those transactions to create a larger number of fees takes advantage of this situation and is therefore abusive under the Dodd-Frank Act.

Mandatory Arbitration

The Dodd-Frank Act gives the CFPB the authority to conduct a study of mandatory arbitration in consumer financial contracts and limit or prohibit these agreements.[39] While the CFPB is studying mandatory arbitration, it should also look at cost shifting provisions highlighted in a recent report by Pew. The report, *Hidden Risks*, found that some account agreements require accountholders to pay the "loss, costs, and expenses" incurred by the financial institutions if the consumer sues the financial institution in court. These contract terms do not differentiate between when the institution wins and when the customer wins the lawsuit. These clauses are unfair to consumers and can have a chilling effect on accountholders who are potential victims of illegal practices, as they can deter customers from bringing a dispute.

Conclusion

We look forward to working with you as the CFPB implements new rules to protect consumers from dishonest practices and improves clarity in the checking account market. Thank you for your consideration.

Sincerely,

Pew Charitable Trusts
Consumer Action
The Consumer Federation of America
Consumers Union
Jewish Women International
NAACP
National Council of La Raza
North Carolina State Employees Credit Union
U.S. Public Interest Research Group

Cc: Leonard Chanin, Assistant Director, Regulations
David Silberman, Assistant Director, Card and Prepaid Markets
Corey Stone, Assistant Director, Credit Information Markets

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[1] A number of the undersigned organizations have additional policy recommendations that are not discussed in this letter.

[2] Brian K. Bucks, Arthur B. Kennickell, Traci L. Mach, and Kevin B. Moore, "Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances," Federal Reserve Board - Division of Research and Statistics (Feb. 2009), available at http://www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf.

[3] Pew Health Group, "Hidden Risks: The Case for Safe and Transparent Checking Accounts" (April 2011), available at http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Banking_Opportunities_Project/Pew_Report_HiddenRisks.pdf. (In October of 2010, the Pew Health Group conducted a study of the 265 account agreements offered online by the 10 largest banks in America by deposit volume. Data in this letter are from this report unless otherwise noted).

[4] Pew Health Group, "Checking Account Customers Support Stronger Banking Regulations, Pew-Commissioned Poll Finds" (July 2011), available at http://www.pewtrusts.org/news_room_detail.aspx?id=85899362358.

[5] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), §§ 1028(b), 1031(a)-(b), 1084(1), 1100B(1), 1100H.

[6] Truth in Savings Act, 12 U.S.C. § 4303(a), (d).

[7] Id. § 4308 (providing authority to issue regulations and model forms); § 4309 (providing authority to enforce compliance with TISA requirements). See also, id. § 4303(e) (noting that disclosures must be clear, in plain language, and readily understandable).

[8] Electronic Fund Transfer Act, 15 U.S.C. § 1693c(a).

[9] Id. §§ 1693o, 1693b(b).

[10] 12 C.F.R. §§ 205.7, .17, 230.4.

[11] Recent studies by both U.S. PIRG and the U.S. GAO found that nearly one-quarter of branches visited did not provide required fee schedules on request. U.S. PIRG (April 2011), "Big Banks, Bigger Fees: A National Survey of Bank Fees and Fee Disclosure Policies," available at http://www.uspirg.org/home/reports/report-archives/financial-privacy--security/financial-privacy--security/big-banks-bigger-fees-a-national-survey-of-bank-fees-and-fee-disclosure-policies2 Also see U.S. Government Accounting Office, (January 2008) "Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts," #08-281, available at http://www.gao.gov/new.items/d08281.pdf

[12] Prior to the confirmation of a director, the CFPB has the power to write rules on enumerated consumer laws, such as TISA and the EFTA. The Dodd-Frank Act gives the CFPB rule-writing authority for all current federal consumer financial laws (transferring them from the Federal Reserve and other agencies that now have that authority). This means the CFPB could write rules requiring a disclosure box and full disclosure of overdraft options.

[13] 12 C.F.R. § 205.17.

[14] Dodd-Frank Act, § 1031.

[15] Id. § 1031(c)(1)(A).

[16] Unfair or Deceptive Acts of Practices, 74 FR 5498 (Jan. 29, 2009); Statement for FTC Credit Practices Rule, 49 FR at 7743 (March 1, 1984).

[17] Dodd-Frank Act, § 1031(c)(1)(A).

[18] Final Rule, Unfair or Deceptive Acts or Practices, 74 FR 5498; FTC Policy Statement on Unfairness (Dec. 18, 1980).

[19] Id.

[20] Dodd-Frank Act, § 1031(c)(1)(B).

[21] Final Rule, Unfair or Deceptive Acts or Practices, 74 FR 5498; FTC Public Comment on OTS-2007-0015 (Dec. 12, 2007), available at http://www.ots.treas.gov/docs/9/963034.pdf.

[22] Final Rule, Unfair or Deceptive Acts or Practices, 74 FR 5498; FTC Policy Statement on Unfairness (Dec. 18, 1980).

[23] Press Release, Moebs Services, Overdraft Fee Revenue Drops to 2008 Levels for Banks and Credit Unions, (Sept. 15, 2010), available at http://www.moebs.com/Pressreleases/tabid/58/ctl/Details/mid/380/ItemID/193/Default.aspx

[24] Federal Deposit Insurance Corporation, "Study of Bank Overdraft Programs" (November 2008), available at http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf.

[25] E.g. Chase, "Important Notice about your Chase checking account" (2010).

[26] Dodd-Frank Act, § 1031(a).

[27] Id., § 1031(d).

[28] Id.

[29] Gutierrez v. Wells Fargo Bank, 730 F. Supp. 2d 1080 (N.D. Cal. 2010).

[30] Id.
[31] In re: Checking Account Overdraft Litig., MDL, 2011 U.S. Dist. LEXIS 66669 (S.D. Fla. June 3, 2011).
[32] Gutierrez, 730 F. Supp. 2d 1080.
[33] Final Rule, Unfair or Deceptive Acts or Practices, 74 FR 5498.
[34] Final Rule, Unfair or Deceptive Acts or Practices, 74 FR 5498; FTC Policy Statement on Deception (Oct. 14, 1983).
[35] Id.
[36] Id.
[37] Id.
[38] Gutierrez, 730 F. Supp. 2d 1080 at 1114.
[39] Dodd-Frank Act, § 1028(a)-(b).