

February 25, 2008

By electronic delivery

Leslye A. Arsht, Deputy Under Secretary of Defense  
Military Community and Family Policy  
Office of the Under Secretary of Defense  
4000 Defense Pentagon  
Washington, DC 20301-4000

Re: Docket No. DOD-2006-0S-0216  
Implementation of Limitations on Terms of Consumer Credit to Service  
Members and Dependents

Dear Ms. Arsht,

The undersigned trade associations, representing almost every insured depository institution operating within the United States, appreciate the opportunity to provide our comments to the Department of Defense (the Department) regarding the implementation of limitations on the terms of consumer credit to Service members and their dependents by these institutions. These limitations were established by the John Warner National Defense Authorization Act for Fiscal Year 2007, section 670, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents" (the Payday Lending Law)<sup>1</sup> and the Department's implementing regulation.<sup>2</sup>

The Department's regulation focuses on three products that have been identified as trapping Service members and their families in cycles of financial difficulties: payday loans, tax refund anticipation loans, and vehicle title loans. It is important to recognize that these products have been offered primarily by non-depository institutions. We have cautioned the Department against an overly broad regulation lest legitimate, beneficial credit be denied to Service members and their families. Similar concerns were expressed by the Senate Armed Services Committee (the Committee) which, in commenting on a proposed draft of the regulation (which was adopted largely as proposed), stated that the Committee "recognize[d] the need for sound discretion in ensuring Service members have access to credit while also ensuring that barriers to predatory lending practices are implemented as Congress intended."<sup>3</sup> The Committee directed the Department to report by April 1, 2008 on the Department's implementation of the Payday Lending Law.

---

<sup>1</sup> Pub. Law 109-364.

<sup>2</sup> 32 C.F.R. Part 232 (effective Oct. 1, 2007).

<sup>3</sup> Item of Special Interest in Senate Report 110-077, at 355-356.

We urge the Department, as it assesses the effectiveness of its regulation, to continue its careful and effective approach of protecting Service members and their dependents against abusive lending practices while ensuring that access to beneficial financial products and services is maintained. For reasons discussed below, the products now under review by the Department – namely, military installment loans, particular credit card programs, and fee-based courtesy overdraft products – each merit a unique response but none require an amendment to the Department’s regulation.

In this letter we wish to make the following points:

- The Department struck the correct balance with the current rule, addressing problems with abusive lending while still ensuring that military personnel and their families continue to have access to beneficial mainstream credit and bank products.
- It is not practicable to expand the regulation as some have proposed without depriving Service members and their families of valuable mainstream financial products. The institutions represented by the undersigned associations are highly regulated and closely supervised, and steps that might serve as barriers to depository institutions offering beneficial products and services only serve to open the door for unscrupulous lenders.
- Other enforcement tools also should be used to address problems. For example, problems with military installment loans should be addressed by focusing on the actions of the particular lender, not the general product. Likely abuses involve a small number of lenders. Now that the final rule is in place and operative, an effective approach would be to re-evaluate the Armed Forces Disciplinary Control Board process as a tool to combat the unscrupulous lender, both at the lender’s physical and virtual locations.
- It is important to recognize that the federal banking agencies are taking steps designed to address related problems as they apply to all consumers, including Service members and their dependents. For example, the Federal Reserve Board is specifically addressing high cost credit cards on an industry-wide basis. Similarly, the agencies are monitoring courtesy overdraft programs and have already issued guidelines for depository institutions. Properly used, paying overdrafts on a discretionary basis rather than denying payments is a valuable service to Service members and the general public. Additional regulation that would be military-specific is unnecessary and could be counter-productive.<sup>4</sup>

---

<sup>4</sup> Disparate rules and requirements can be a regulatory burden that serves as a barrier to depository institutions offering beneficial financial products and services.

## **1. The balance struck in the Department's rule remains appropriate.**

The Department acted wisely in adopting a rule that focused on those credit products that have been the primary source of problems for Service members and their dependents. The Department struck an appropriate balance in the regulation that accorded significant protections to Service members and their dependents while minimizing the potential for unintended adverse consequences.

The lenders represented by the undersigned associations are subject to a myriad of consumer finance protection laws and guidance. While illustrative lists of the various laws have been provided in previous submissions to the Department,<sup>5</sup> the extraordinary scope of matters regulated merits emphasis. Among the laws that protect all consumers, including Service members and their dependents, include but are not limited to the following:

1. Truth In Lending Act
2. Equal Credit Opportunity Act
3. Real Estate Settlement Procedures Act
4. Fair Housing Act
5. Home Mortgage Disclosure Act
6. Fair Credit Reporting Act
7. Truth in Savings Act
8. Consumer Leasing Act
9. Fair Debt Collection Practices Act
10. Federal Trade Commission Act Section 5 (prohibiting unfair and deceptive acts and practices)
11. Homeowners Equity Protection Act of 1994 (HOEPA)
12. Electronic Funds Transfer Act
13. Credit Practices Rule
14. Expedited Funds Availability Act
15. Fair Credit and Charge Card Disclosure Act
16. Fair Credit Billing Act
17. FDIC Supervisory Policy on Predatory Lending, FIL-6-2007
18. OCC Advisory on Payday Lending: OCC AL 2000-10
19. OCC Advisory on Predatory Lending: OCC AL 2003-2
20. OTS Memorandum for Chief Executive Officers on Payday Lending
21. OTS Memorandum for Chief Executive Officers on Title Loan Programs
22. Predatory lending brochure released jointly by the 4 banking agencies, FTC, DOJ, HUD, FHFB, OFHEO, and NCUA
23. OCC and OTS guidance on Gift Card Disclosures
24. Interagency Guidelines on Nontraditional Mortgages (adopted by the federal banking agencies and most state lending regulatory agencies)
25. 1999 Interagency Guidance on Subprime Lending

---

<sup>5</sup> See, e.g., letter from Wayne Abernathy to The Hon. Dr. David S. C. Chu, dated January 23, 2007.

26. 2001 Interagency Expanded Guidance for Subprime Lending Programs
27. 2007 Interagency Statement on Subprime Lending (adopted by the federal banking agencies and most state lending regulatory agencies)

The following directives also govern military banks and credit unions operating on DOD installations:

28. DOD Financial Management Regulation 7000.14-R, Volume 5, Chapter 34, Procedures Governing Banks, Credit Unions and Other Financial Institutions on DOD Installations, September 2007
29. DOD Directive 1000.11, Financial Institutions on DOD Installations, June 9, 2000
30. DOD Instruction 1342.17, Personal Financial Management for Service Members, November 12, 2004
31. DOD Instruction 1344.7, Personal Commercial Solicitation on DOD Installations, March 30, 2006
32. 32 C.F.R. Part 232, Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule, August 31, 2007.

While these are not the only rules and guidelines that apply, they clearly illustrate the extensive protections that exist and that protect Service members and their dependents when doing business with insured depository institutions.

The banking agencies examine insured depository institutions frequently (and, for the largest banks, on a continual basis) to ensure that the institutions comply with these laws and provide full and fair access to credit for all qualified borrowers. Moreover, insured depository institutions constantly monitor their practices and adjust as circumstances warrant. Simply put, insured depository institutions must maintain the public's trust in order to survive.

Given the extraordinary extent to which insured depository institutions are regulated and supervised, it is no surprise that the problems that gave rise to the Payday Lending Law arose from transactions involving lenders that are not insured depository institutions. The Department's *Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, dated August 9, 2006 (the DOD Report) repeatedly focused on the abuses by payday lenders and other types of lenders that are not subject to the extensive consumer protection laws and supervisory regime within which insured depository institutions operate. Of the case studies provided in the DOD Report of the impact of predatory loans on Service members, 13 of the 17 examples involved people who had become trapped by spiraling debt resulting from multiple payday loans.<sup>6</sup> The remaining examples involved Service members who had run into trouble with car title loans, military installment loans, and loans from rent-to-own companies. None of the examples cited appear to have involved an insured depository institution. Indeed, the DOD Report favorably singled out

---

<sup>6</sup> DOD Report, at 39-42.

several insured depository institutions for their efforts at meeting Service members' need for small-denomination, short-term loans at a reasonable cost.

## **2. Issues concerning military installment loans should be addressed by focusing on the actor, not the product.**

One issue identified by the Department during the development of its regulation was the difficulty of defining "installment loan" in a way that addressed the problems experienced by Service members and their dependents while not inadvertently cutting off access to legitimate, beneficial products. The final rule described "military installment loan" as an "installment loan marketed primarily or exclusively to the military."<sup>7</sup> In discussing why these loans were not included as a separately-identified class of loans that are subject to the regulation, the Department stated:

[T]here are installment loans with favorable terms and some with terms that can increase the interest rate well beyond the limits prescribed by 10 U.S.C. 987. Isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing the regulation. Consequently, installment loans that do not fit the definition of "consumer credit" in [32 C.F.R.] Section 232.3(b), including the definition of "payday loans," "vehicle loans," or "tax refund anticipation loans" are not covered by the regulation. The Department's intent is to balance protections with access to credit. The protections posed in the statute assist Service members, when applied with precision to preclude unintended barriers.<sup>8</sup>

We believed then, and continue to believe, that the Department acted wisely in taking this approach. The vast majority of insured depository institutions offer "installment loans" if that term is used to refer to an extension of credit that is repaid in periodic payments. However, at most only a very small subset of the larger universe of installment loans was the focus of the DOD Report. That subset consists of installment loans that are made by the very few lenders that focus their marketing of such loans primarily or exclusively on members of the military. Moreover, trying to develop a definition of "military installment loan" without covering *all* types of installment loans will be confusing and will lead to the types of unintended consequences that would become a barrier to credit for Service members and their dependents.

Given the small number of lenders who offer the type of credit product that has caused problems, and given the inherent uncertainty and probable unintended adverse consequences that will result from any attempt to regulate all installment loans currently available to the military, we strongly urge the Department to keep the scope of its regulation narrow. Issues identified by the

---

<sup>7</sup> 72 Fed. Reg. 50580, 50582 (Aug. 31, 2007).

<sup>8</sup> *Id.*

Department with installment loans should be addressed in a targeted fashion, focusing on the handful of actors that are engaged in practices the Department finds problematic. Any attempt at a broader approach that focuses on a product quickly raises issues of how to define the product in a way that addresses the Department's concerns without unintentionally curtailing access to products that are legitimate and beneficial.

We believe the Department can avoid this problem by using two vehicles that permit a more precise response: the Armed Forces Disciplinary Control Board (the Disciplinary Control Board) and memoranda of understanding (MOUs) with State and federal regulators concerning referral of complaints and sharing of enforcement information.

a. Disciplinary Control Board. We urge the Department to consider using the Disciplinary Control Board to address problems arising out of the unscrupulous lenders who persist in making military installment loans on terms that the Department finds objectionable. We believe that early indicators show that the provisions of the Department's regulation are having the desired effect of restricting access to the loans deemed problematic. For instance, an article recently published in the *Army Times*, *Air Force Times*, and *Navy Times* highlighted the impact that the regulation is having on tax refund anticipation loans. That article stated, "These loans have pretty much dried up for those in the military community, largely because of a 2006 law capping the interest rate on consumer loans to the military community – including payday and refund anticipation loans – at 36 percent."<sup>9</sup> We understand anecdotally that several payday lending offices that were operating near military installations in the San Diego area before the Payday Lending Law are now closed.<sup>10</sup>

Because of the impact that the Payday Lending Law and the Department's implementing regulation are having on payday lending, the Department should reconsider the Disciplinary Control Board as a tool of choice for commanders. The Disciplinary Control Board process allows the military to address fairly and uniformly the effects of predatory loans offered by lenders who target military personnel. Under current Department joint policy, when the Disciplinary Control Board concludes that an establishment has unfair commercial or consumer practices, an installation commander can prohibit Service members from frequenting the business by placing the entity on an off-limits list. If a commander declares a business to be off-limits, Service members face disciplinary action if they violate this prohibition.

Disciplinary Control Boards and the recommendations they make to installation commanders to place businesses off-limits to Service members have

---

<sup>9</sup> *Army Times*, February 18, 2008, at 38; *Air Force Times*, February 18, 2008, at 40; and *Navy Times*, February 18, 2008, at 40.

<sup>10</sup> For a discussion of the efforts insured depository institutions have made to ensure that credit needs of Service members are fully met, see section 4, *infra*.

proven effective in correcting or eliminating unfair practices. The Government Accountability Office (GAO) concurred in its April 26, 2005 report, *Military Personnel: DOD Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized*, citing the Disciplinary Control Board as one of three tools available to address the use and effects of loans that the Department considers predatory. According to the GAO, Disciplinary Control Boards and the recommendations that they make to an installation commander to place businesses off-limits to Service members can be effective tools for avoiding or correcting unfair practices. However, *the GAO found that this tool was underutilized for curbing predatory lending practices and the effects of such lending*. The GAO recommended that the Department amend existing regulations to require installation commanders to convene the Disciplinary Control Board at least semiannually to investigate and make recommendations to commanders on matters related to eliminating conditions which adversely affect the health, safety, morale, welfare and discipline of the Armed Forces, “to include service members’ use of lenders who may use predatory lending practices.”<sup>11</sup>

The Disciplinary Control Board was acknowledged in the DOD Report as an avenue to declare a lender off-limits. However, the process was generally deemed unsuitable to deal with businesses that work within the law. In states that authorized payday lending prior to the adoption of the Department’s regulation, Disciplinary Control Boards would have had to establish their own local guidelines in addition to the provisions of state law, ensure all affected business are aware of these new guidelines, and then monitor whether these businesses comply when dealing with military personnel. The Department believed the number of payday lending outlets then existing around military installations would overwhelm a process designed to review one location at a time. Given the large numbers of payday entities, a process that would have required a board to review so many locations on an individual basis would have been unwieldy. Moreover, such efforts would have been ineffective unless actions were brought against all payday lenders that did business with Service members or their dependents.

Clearly, the overriding impediment was one of process, and the Department concluded that the “magnitude of mediating with the number of outlets surrounding military installations has exacerbated the process.”<sup>12</sup> In its response the Department acknowledged that it was not at that time in the position to establish regulations to limit payday lenders and to provide the necessary oversight to ensure they comply. However, we believe that the circumstances that made the Disciplinary Control Board less effective then are no longer prevalent.

---

<sup>11</sup> GAO-05-349 (April 26, 2005), pp. 18-19 (available at <http://www.gao.gov/new.items/d05349.pdf>).

<sup>12</sup> 72 Fed. Reg. at 50583.

Today the Department has a regulation that appears to be addressing the payday lending issue effectively. Given the comparatively few bad actors offering military installment loans on abusive terms, the Disciplinary Control Board process can be very effective. If need be, the Disciplinary Control Board rules can be amended by the Department to strengthen it as a commander's weapon to combat predatory lenders who target military personnel and whose lending products and practices are illegal, are unfair, or contain terms that are detrimental to the military borrower. This is not limited to those with a physical presence near military installations; it also may be used in connection with those which operate over the Internet. Lenders who violate the provisions of 32 C.F.R. Part 232, or who seek to provide predatory products that are targeted to military personnel and which are designed to circumvent the provisions of the Payday Lending law, can be investigated and sanctioned through the Disciplinary Control Board process.

We believe the Disciplinary Control Board process could be employed to address lending practices that may not be "illegal" by law or regulation but which are clearly abusive and "unfair." A commander, through the board, could use 32 C.F.R. Part 232 as a benchmark for determining whether a lender is predatory, e.g., offering a product deliberately designed to circumvent the prohibitions of 32 C.F.R. Part 232. In placing a lender "off limits," commanders are able to communicate to the members of their command, and to the members' families, that this lender is to be avoided. For the military member the risk of receiving disciplinary action for patronizing the lender sends a strong message that the lender should not be used. Now that the final rule regarding consumer credit is in place, we urge the Department of Defense to consider strengthening the use of this tool.

b. MOUs with State and federal regulators. In order for the Department to monitor effectively the enforcement of its regulation, the Department likely will need to rely on strong coordination with appropriate State and federal agencies. Since many of the creditors that offer these loans are state chartered or licensed, coordination with the states will be particularly important. If, for instance, the Department wants a state-licensed non-bank lender to stop offering credit to Service members on abusive terms, the Department may wish to bring the situation to the attention of the State agency that supervises the lender in question. Such a referral could be made with the understanding that the receiving entity would investigate, take action as appropriate, and report back to the referring agency.

To effect such a referral arrangement, the Department should consider entering into MOUs with appropriate State and federal agencies to ensure that issues will be brought to the attention of the appropriate party. The MOU would enhance the communication and exchange of information between the Department and these agencies. Although all information disclosed within the report would be kept confidential between the Department and the applicable

agency, neither the Department nor the agency would be limited from conducting any of its regulatory activities.

Precedent exists for such MOUs. The Office of the Comptroller of the Currency (OCC) has entered into several MOUs with States that assign responsibility for (i) referring matters to the agency with primary jurisdiction, (ii) reporting back to the referring agency on how the matter gets resolved, and (iii) preserving the confidentiality of the information referred. Attached at Appendix 1 is a model MOU that was prepared by the OCC and the Conference of State Bank Supervisors (CSBS).

This system of referrals pursuant to an MOU would enable targeted enforcement against individual actors in situations that do not warrant an industry-wide response. In addition, it would minimize duplication of efforts and ensure a system of communication that would contribute to a robust system for protecting Service members and their families.

### **3. A military-specific response to low-balance, high-fee credit cards and courtesy overdraft products is unnecessary.**

The landscape of bank regulation is constantly evolving as lawmakers and insured depository institutions respond to issues as they arise. The flurry of activity to address problems stemming from subprime mortgage lending is but one example of how system-wide issues are being addressed by Congress, the banking agencies, and the market. While undoubtedly there are Service members who are experiencing difficulties in connection with subprime mortgage loans, the subprime issues do not call for a military-specific response. Instead, the solutions currently being developed will apply more broadly to *all* consumers, including but not limited to Service members and their dependents.

The Department has highlighted two other products in its solicitation of comments where lawmakers and the private sector are working to develop an appropriate, system-wide response that permits consumers full access to legitimate products offered by institutions that operate safely and soundly. These products are credit cards “that are characterized by minimal available credit coupled with high fees” and “[f]ee-based, high-cost, courtesy overdraft products.”<sup>13</sup> For the reasons discussed below, we believe that these do not warrant a military-specific regulation.

a. Low-balance, high-fee credit cards. The Department has invited comment on whether additional regulation is needed to curb abuses connected with credit cards that offer little available credit but charge relatively high fees. These programs as described as extending a line of credit to an applicant but, when the card is received, the applicant discovers that miscellaneous fees and charges consume most of the initial available credit.

---

<sup>13</sup> 72 Fed. Reg. 73336, 73337 (Dec. 27, 2007).

The undersigned associations agree that these programs can be abused. However, the Federal Reserve Board has taken steps to address this issue by proposing revisions to its rules governing credit cards under Regulation Z (which implements the Truth-in-Lending Act).<sup>14</sup> To avoid confusion about cards with low credit limits and high fees, the Federal Reserve Board has proposed that certain information for such cards be included in a highlighted table of important terms that are provided to consumers. Specifically, if the total fees for the card equal or exceed 25 percent of the remaining credit after fees and any security deposit are debited, the card issuers must disclose in the table the remaining credit available. The table must be highlighted and be included in credit card applications and account opening disclosures.

Following is the Federal Reserve Board's proposed language:

*Available credit.* If a card issuer requires fees for the issuance or availability of credit ..., or requires a security deposit for such credit, and the total amount of those required fees and/or security deposit that will be imposed when the account is opened and charged to the account equal 25 percent or more of the minimum credit limit offered with the card, a card issuer must disclose the available credit remaining after these fees or security deposit are debited to the account, assuming that the consumer receives the minimum credit limit. In determining whether the 25 percent threshold test is met, the issuer must only consider fees for issuance or availability of credit, or a security deposit, that are required. If fees for issuance or availability are optional, these fees should not be considered in determining whether the disclosure must be given. Nonetheless, if the 25 percent threshold test is met, the issuer in providing the disclosure must disclose the amount of available credit excluding those optional fees, and the available credit including those optional fees.

In proposed commentary to that section, the Federal Reserve states:

If the 25 percent threshold test is met, the issuer must disclose the available credit excluding optional fees, and the available credit including optional fees. In calculating the available credit to disclose in the table, the issuer must consider all fees for the issuance or availability of credit described in § 226.5a(b)(2), and any security deposit, that will be imposed when the account is opened and charged to the account, such as one-time issuance and set-up fees that will be imposed when the card is opened. For example, in calculating the available credit, issuers must consider the first year's annual fee and the first month's maintenance fee

---

<sup>14</sup> 72 Fed. Reg. 32973 (June 14, 2007). The comment period closed October 11, 2007. The Federal Reserve is reviewing the comments it received and has indicated it plans to issue a final rule at the end of the second quarter this year.

(as applicable) if they are charged to the account on the first billing statement.

The undersigned associations agree with this approach. The new disclosures will make it readily apparent when a new credit card comes with fees and other charges that use up a high percentage of the available credit. It is important that consumers easily understand what they are being offered before they agree to accept a card that will result in a low available balance and high fees. The mandatory clear and conspicuous disclosures will help borrowers understand the impact that initial fees and charges will have and help encourage borrowers to consider alternative sources of credit.

We believe this approach will effectively balance the need to prohibit abusive practices while preserving access to credit. Accordingly, we also believe that the Department need not regulate further in this area but should rely instead on the solutions being devised by the banking regulators that will apply to all consumers, including Service members.

The banking industry is working hard to ensure that consumers understand the credit products available to them. A sample of the efforts related to credit cards is discussed in further detail in section 4 regarding financial literacy, below, and the materials cited therein. We respectfully submit that the combination of better disclosures and greater financial literacy is the more appropriate and effective way to address issues arising from credit products that can be abused. Where the federal banking agencies are taking steps to address problems for all consumers, and those steps will address the concerns raised by the Department, it is unnecessary to craft separate and unique military-specific rules.

b. Overdraft products.

i. *Background.* Any consideration of overdraft products requires a discussion of the context in which these products are offered and the recent efforts by the banking industry and the bank regulators to strike the right balance between regulation, customer convenience, and innovation.

American consumers enjoy the easiest and most affordable access to banking services, including checking accounts, of any country in the world. Today, in almost any city in the United States, consumers can open a checking account with a minimal deposit and have access to the entire menu of payment services for free. Consumers can write checks, use debit cards to withdraw cash or make purchases, pay bills and make funds transfers online 24 hours a day, 7 days a week, from virtually anywhere in the world **at no charge**, whether to a business next door or half-way around the globe. However, consumers need to keep track of their transactions and balances. If they do not, they may attempt to access funds that do not exist.

Consumers appreciate overdraft protection. It is a service that allows them to avoid the embarrassment, hassle, costs, and other adverse consequences of having a check bounce or transaction denied. For example, returning a payment to a merchant, mortgage company, or credit card company, whether made by check or electronically, usually means the consumer pays additional fees charged by the person receiving the payment. Consumers also suffer the inconvenience of having to resolve the issue and arrange a second payment. They risk having adverse information reported to a credit bureau or “bad check” database. Given that the fee for incurring an overdraft is the same as the fee for returning an item, consumers appreciate the depository institution paying items when there are insufficient funds.

Courtesy overdraft protection is particularly important to the military customer who can have his or her check cashing privileges at installation facilities suspended or revoked, face possible adverse administrative or disciplinary action, and have his or her security clearance affected because of returned checks. Loss of a military member’s security clearance is a serious matter, because it ultimately affects military readiness.

For many years, insured depository institutions have extended the courtesy of paying checks drawn against insufficient funds. The primary innovation in this area is that the more recent overdraft protection practices rely on automated systems that may depend in part on the historical activity of the account and the likelihood that the accountholder will cover the overdraft.

The advantage of the automation of the historical practice of paying overdrafts on a discretionary basis is that it 1) reduces costs associated with case-by-case assessment and manual intervention and 2) ensures consistent treatment of customers so that some customers are not inadvertently favored based on inappropriate factors.

“Bounce protection” programs are a subset of discretionary overdrafts. In bounce protection programs, the criteria for paying an overdraft and the discretionary limits may be disclosed.<sup>15</sup>

---

<sup>15</sup> Bounce protection products are different from, and should not be confused with, overdraft **lines of credit** or other types of overdraft protection products. Overdraft lines of credit are basically open-end credit agreements. Unlike overdraft protection, for overdraft lines of credit customers must complete applications and are subject to the bank’s underwriting process. Credit reports are usually used to determine eligibility. When an overdraft is paid, the customer typically pays a transaction fee in addition to interest. In other similar overdraft programs, funds to cover the overdraft are taken from a savings account or charged to a credit card. With overdraft lines of credit and these alternative programs, the bank agrees that it **will** pay overdrafts up to the agreed amount. In contrast, with “bounce protection,” banks pay overdrafts on a discretionary basis and do **not** promise to pay any particular overdraft. Some bank customers choose not to have overdraft lines of credit to avoid the temptation of incurring a debt in the amount of the credit line. Knowing that checks will be paid regardless of whether there are funds in the account to cover the check removes a discipline that many consumers find helpful.

When insured depository institutions implement automated “bounce protection” programs, they often explain to customers that the institution **may** pay overdrafts, usually between \$100 and \$500, depending on the customer, under certain circumstances. Examples of typical criteria for eligibility for the service include:

- Minimum monthly deposit
- Periodic direct deposit
- No outstanding debts to the bank
- Account opened for at least 30 days
- Minimum number of overdraft episodes over a certain period of time.

The on-installation banks that predominately service military customers do not encourage overdrafts. These institutions make every effort to pay their military customers’ items and to do so in a fair manner. Their rates and fee schedule are disclosed to the customer and the customer is notified that an overdraft can be created by check, in-person withdrawal, ATM withdrawal or other electronic means. One illustrative military bank adds a specific section in its rate and fee schedule about overdrafts and returned checks.<sup>16</sup>

Consumers also value having debit card transactions approved even when there are insufficient funds. Many consumers are aware of, and avail themselves of, the fact that in the morning they may use their card to obtain cash or make a purchase with their debit card even if there are insufficient funds, so long as in the afternoon they make a deposit to cover the transactions. They also appreciate having transactions approved as a matter of convenience. For example, in restaurants consumers would rather have their transaction authorized than face the embarrassment of not being able to pay for a meal they have just consumed, even if the authorization will result in a fee. Similarly, after a couple of hours grocery shopping, waiting in line, and having the groceries rung up, they often will want the depository institution to authorize the transaction even though there are insufficient funds and even though they may have to pay a fee.

Overdraft and returned item fees are avoidable. Customers can avoid overdrawing their accounts by keeping track of their transactions, which is progressively easier to do. Customers can check account activity online or by phone to ensure that they have not overlooked or forgotten to enter transactions on a ledger. Even if they do not keep an accurate, up-to-date account of their transactions and balance, they can check the balance by phone, at the ATM, or

---

<sup>16</sup> The disclosure in question states, “Overdrafts occur from time to time on an account. We discourage you from overdrawing your accounts because it may damage your credit and overdraft fees are expensive. It is important that you know your account balance prior to writing a check, using your debit card or using an ATM. We do not guarantee all items will be paid and they will be returned.”

online just prior to a transaction.<sup>17</sup> Of course, only customers can know what their actual balance is – only they know what checks they have written, automatic payments they have authorized, and debit card transactions they have approved that have not yet hit the bank. Another option for consumers is to maintain a “cushion” in the balance as a margin for error.

As noted by the Department in its final rule, insured depository institutions often monitor their customers’ use of overdraft protection products in order to help the customers avoid the problems that can arise from misuse. The preamble to the final rule states: “Many of these military banks ... use their products and services to maintain a watchful eye over their members to ensure they do not abuse services designed to assist them, such as overdraft protection, which if used on a chronic basis, can become very expensive and propel someone already overextended into a deeper spiral of debt.”<sup>18</sup> What is important to recognize is that banks use existing monitoring tools to identify customers having difficulty and work with them to ensure the customers are able to manage the account.

One bank with branches located on several military installations has a program called EB Mobile which gives its military customers the option of no-fee access to checking, savings, or money market accounts using an Internet-enabled mobile device (cell phone or PDA). This allows Service members to keep track of their funds at any time from anywhere in the world. It also can provide automatic alerts for account balances, which enables the bank’s military customer to monitor and track transactions as well as transfer funds between the customer’s accounts.

Many depository institutions permit customers to opt out of having overdrafts paid. However, they usually still have to pay a fee for an item that is returned. In addition, the option usually means that *all* transactions, not selected types of transactions, such as debit card transactions, will be returned or denied.<sup>19</sup>

Depository institutions, upon request, will often waive the fee for an initial or occasional overdraft. After the first incident, the consumer is then aware in the future that debit card transactions may cause an overdraft and can take appropriate steps to avoid them. Customers dissatisfied with their depository institution’s fees can also move to another competing depository institution.

If courtesy overdraft products remain problematic despite the best efforts of customers and their insured depository institutions, then they have other

---

<sup>17</sup> The balance provided may not reflect outstanding transactions that the customer has authorized but have not yet reached the bank and been processed.

<sup>18</sup> 72 Fed. Reg. at 50583.

<sup>19</sup> Current operational restrictions and limits on technology prevent banks from allowing customers to segregate the transactions for which the opt-out would apply.

options to avoid overdraft fees. They can arrange to have overdrafts paid through an overdraft line of credit, credit card, or savings account. Typically, these options are less costly than overdraft fees, but customers must qualify. Customers may also be able to set an “alert” with the institution, warning them that their balance has fallen below a set amount.

ii. *Industry guidelines.* The banking industry has initiated efforts to ensure that overdraft protection products are offered responsibly. For example, in March 21, 2003, a letter was sent to all American Bankers Association (ABA) members from Ken Ferguson, then ABA Chairman-Elect to advise caution with regard to overdraft practices and offer specific suggestions. Subsequently, ABA partnered with Alex Sheshunoff Management to publish and distribute to all ABA members more extensive guidelines, captioned *Overdraft Protection: A Guide for Bankers* (attached at Appendix 2). These documents recommended that depository institutions:

- Disclose costs and terms in the agreement fully and conspicuous;
- Make clear that the depository institution is not promising to pay items;
- Avoid encouraging customers in marketing materials, advertising, and communications to overdraw;
- Monitor accounts for frequent use of the service and take appropriate actions in these situations;
- Inform customers of other ways to handle overdrafts, such as lines of credit and automatic transfers; and
- Proactively offer an “opt-out.”

The other undersigned associations have taken similar steps to work with their members to ensure that overdraft protection programs are offered responsibly as a service to customers. Many have partnered with responsible vendors to offer this service. For example, the Independent Community Bankers of America (ICBA) has endorsed a program offered by Profit Technologies.

In early 2005, the banking agencies adopted their *Overdraft Protection Program Guidance* (Guidance) that reflected many of the industry’s recommendations.<sup>20</sup> The agencies’ Guidance addresses legal and safety and soundness issues, while also setting out best practices. Specifically, the Guidance recommends that depository institutions:

- Avoid promoting overdrafts;
- Fairly represent overdraft protection programs and alternatives;
- Train staff to explain program features and choices;
- Clearly explain the discretionary nature of programs;
- Clearly disclose program fees;
- Demonstrate when multiple fees will be charged;

---

<sup>20</sup> See, e.g., FDIC FIL-11-2005 issued February 18, 2005.

- Explain the impact of transaction clearing polices; and
- Illustrate the types of transactions covered including card transactions, preauthorized automatic debits, telephone-initiated transfers, and other electronic transfers.

The Guidance also offers specific best practices related to program features and operations. For example, depository institutions should:

- Provide election or opt-out for the service;
- Alert consumers, where feasible (e.g., at a teller window) before a transaction triggers any fees;
- Prominently distinguish balances from overdraft protection funds availability;
- Promptly notify consumers of overdraft protection program usage each time used;
- Consider daily limits on consumers' costs;
- Monitor overdraft protection program usages; and
- Fairly report program usage.

In addition, the Federal Reserve Board amended Regulation DD (Truth in Savings) to improve consumers' understanding of the cost of overdrafts.<sup>21</sup> Specifically, the regulation requires depository institutions that "promote" overdraft protection to disclose in periodic statements the total dollar amount of fees for paying overdrafts and the total dollar amount for fees for returning items unpaid. These totals have to be provided for the statement period and for calendar year to date. All depository institutions must also specify the categories of transactions for which an overdraft fee may be imposed, including, for example, ATM withdrawals and point of sale debit card transactions.

The preceding discussion illustrates the extensive protections afforded to customers of insured depository institutions. Courtesy overdrafts are enormously helpful if used responsibly, and the banking industry and regulators have worked hard to ensure this result. Further regulation by the Department is unnecessary and risks making this product unavailable to members of the military and their dependents. The federal banking agencies are closely monitoring overdraft protection programs to ensure that consumers are properly protected, and the agencies have promised to take additional action if necessary.

#### **4. Insured depository institutions offer many credit products that are better alternatives to the types of credit covered by the Department's regulation.**

a. Alternative small-loan products. The banking industry offers many alternatives to payday loans, military installment loans, and the other types of credit products that have contributed to cycles-of-debt problems that gave rise to

---

<sup>21</sup> 70 Fed. Reg. 29593 (May 24, 2005).

the Department's regulation. This was noted in the recent *Army Times*, *Air Force Times*, and *Navy Times* article cited above, where the author writes: "Banks and credit unions offer short-term loans and lines of credit at much lower interest rates [than what was being offered by providers of tax refund anticipation loans] – you might pay one-third of the cost or less over a two-week period."<sup>22</sup> The Department specifically recognized in the preamble to its final rule that insured depository institutions have established programs and products designed to help Service members and their families resolve their financial crises, rebuild their credit and establish savings.<sup>23</sup>

In the course of preparing this comment letter, the undersigned associations gathered information from their members about what insured depository institutions are doing to provide credit to those who otherwise might use payday loans. Our members have responded to the stated need to expand financing options for Service members by offering small-dollar programs geared particularly to the needs of young people in the military. The credit terms typically provide for loan amounts ranging from a minimum of \$100 to a maximum of \$2,000 or more, depending on the institution's loan policy. A streamlined loan application process is also provided. Interest rates are moderate and are generally in the range of 12% to 18%. Fees are minimal and typically do not include prepayment penalties. Terms, of course, reflect current market conditions and therefore vary accordingly.

The insured depository institutions offering these small-dollar, low-cost loans also encourage the borrowers to establish a deposit account relationship with the lender. The institutions offer debit and ATM cards, sometimes at no cost. In some cases Service members are encouraged to open a savings account or purchase a certificate of deposit and borrow against these funds.

---

<sup>22</sup> *Army Times*, Feb. 18, at p. 38; *Air Force Times*, Feb 18, at p. 40; *Navy Times*, Feb 18, at p.40.

<sup>23</sup> The preamble stated:

Financial institutions located on military installations also understand the need to provide products and services that can help those who mishandle their finances and who may need remedial assistance. A review of on-base financial institutions surfaced 24 programs on 51 military installations in the U.S. providing alternative small loan products designed to help Service members and their families to recover from their financial problems. These financial institutions supplement the emergency funding made available by the nonprofit Military Aid Societies that provide grants and no-interest loans to needy Service members and families.

These financial institutions provide low denomination loans at reasonable APRs designed to assist their members who need to get out of high cost credit and into more traditional lending products. Financial counseling and education are often prerequisites for the short term loans and some institutions have attached a requirement to develop savings as part of the loan.

72 Fed. Reg. at 50583.

The institutions responding to our inquiries are active in promoting these small-dollar lending programs. Some use financial literacy programs and community out-reach to promote the availability of this credit. Many of the programs are in their formative stages and word-of-mouth is an important aspect of ensuring that Service members are aware of these credit resources.

While there are many examples of insured depository institutions stepping up to meet the credit needs of Service members and their dependents, we highlight the experience of one bank with branches on 37 military installations to illustrate what has happened since the Department's regulation has become effective. In 2007, the bank made more than 7,700 loans to Service members experiencing financial difficulty for a total of more than \$8,200,000, which represents an 80% increase in the number of loans and a 60% increase in the dollar amount of the loans over the activity for 2006 in which they made more than 4,300 small dollar loans for a total of slightly over \$5,200,000. Of particular significance is the increase in loans during the period October 1 through December 31, 2007, after the Department's regulation went into effect: during that period, the bank made more than 1,900 workout loans for a total of over \$1,800,000, an increase over the number and amount of workout loans made during the same period in 2006 (1,200 loans for a total of \$1,500,000). The bank believes that the increase in the loan amount and loan volume can be attributed to their customers resorting less to payday lenders or payday-like loans and relying more on the bank's small dollar loan program. The bank was one of five Association of Military Banks of America member banks that showcased their alternative small loan products at a Federal Deposit Insurance Corporation (FDIC) Conference in December 2006. The features of these products were later incorporated into FDIC guidelines for affordable small-dollar loan products. It is reasonable to assume that the recent lending experience of that bank will be reflected in the lending activity of other military banks serving military customers.

A separate survey of community banks found that many – if not most – offer some type of affordable small-dollar loan for their customers. However, they often do this on an *ad hoc* basis and not as a separate program that is widely advertised or promoted. What is critical is that these banks are willing to work with individual customers to provide credit products that meet their needs.

These are but a few of the many bank-specific initiatives ongoing. Other initiatives are underway to review the small-loan efforts of the banking industry more broadly and to see if there are sustainable small-loan products that can be identified. For instance, the FDIC is at the early stages of a two-year review of 30 banks which are offering affordable and responsible small-dollar loan products.<sup>24</sup> The stated purpose of this program is to identify effective and replicable business practices that will help insured depository institutions incorporate affordable small-dollar loans into their other mainstream banking services. Although the program is voluntary, it has attracted the interest of many

---

<sup>24</sup> See <http://www.fdic.gov/SmallDollarLoans>.

financial institutions, both large and small, from around the nation. According to the FDIC, the banks have headquarters in 17 states, and have 550 branches located in 27 states.<sup>25</sup> The ultimate goal is to develop a template or model that individual institutions can use to create credit products that meet the needs and unique demands of their local markets and customers – including Service members and their dependents.

The FDIC has also made it clear that a state nonmember bank that establishes a loan program that provides small, unsecured consumer loans consistent with the Affordable Small-Dollar Loan Guidelines would warrant favorable consideration by the FDIC under the Community Reinvestment Act (CRA) as an activity responsive to the credit needs of the institution's community. More broadly, the banking agencies have been clear that small-dollar loan programs are eligible for CRA credit. See, e.g., The Interagency Questions and Answers Regarding Community Reinvestments, question \_\_.22(a)-1.<sup>26</sup>

Further, where small-dollar loan products are combined with a low-cost savings account, institutions may also qualify for favorable consideration for providing community development services.

b. Financial literacy efforts. Financial literacy is an important element in the entire process. Not only must consumers have the information tools to understand credit, they must have the training to use those tools. Unfortunately, America's youth consistently receive a failing grade in personal finance, according to the Jump\$tart Coalition. Adults fare no better, considering nearly 70 percent of people obtaining pre-bankruptcy credit counseling cite poor money management as their reason for seeking bankruptcy protection. Currently, fewer than 20 states require financial education for high school graduates, and many parents feel their own financial shortcomings leave them ill-equipped to teach their children.

To address these issues, the banking industry and the undersigned associations have been very active in promoting financial literacy. Attached at Appendix 3 is a brief overview of some of the initiatives underway to help educate consumers about how to manage personal finances responsibly.

---

<sup>25</sup> <http://www.fdic.gov/SmallDollarLoans/participants.html>.

<sup>26</sup> SECTION \_\_.22(a) Scope of Test

Q1. Are there any types of lending activities that help meet the credit needs of an institution's assessment area(s) and that may warrant favorable consideration as activities that are responsive to the needs of the institution's assessment area(s)?

A1. Credit needs vary from community to community. However, there are some lending activities that are likely to be responsive in helping to meet the credit needs of many communities. These activities include—

\* \* \*

establishing loan programs that provide small, unsecured consumer loans in a safe and sound manner (i.e., based on the borrower's ability to repay) and with reasonable terms.... (Emphasis added.) The CRA questions and answers may be found at <http://www.ffiec.gov/cra/pdf/qa01.pdf>.

Ultimately, creditors must be responsible for providing fair access to credit on reasonable terms that are fully disclosed, and consumers must be responsible for using that credit responsibly. We believe that financial literacy efforts can go a long way to enhancing the ability of consumers to fulfill their end of the bargain.

Military banks must provide noncommercial financial education and counseling services as an integral part of their operations as a condition of obtaining the exclusive right to operate on DOD installations. The Association of Military Banks of America (AMBA) member banks, as part of their responsibility in residing on military installations, provide educational programs to supplement the programs offered by the Military Services. Financial education programs offered by AMBA banks cover the lending practices described in DOD's August 9, 2006, "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents." AMBA banks continue to be integral partners with DOD in the Financial Readiness Campaign and provide financial education as part of their banking program.

\* \* \*

We commend the Department for having struck an appropriate balance in the final regulation and we urge you to permit it to work as implemented so that Service members may continue to have access to beneficial, mainstream products. Effective options exist to address the occasional bad actor, while more systemic issues are being addressed by Congress, the regulators, and the market. We would emphasize the importance of financial literacy to enhance the ability of consumers to make informed decisions. Fundamentally, though, it is important to avoid developing restrictions that could restrict the ability of insured depository institutions to assist Service members and their families and produce the unintended consequence of a fertile environment for unscrupulous non-bank lenders to take advantage of Service members and their dependents.

We thank you for the opportunity to share our views on these matters, and we remain committed to meeting the financial needs of this country's Service members and their families.

Sincerely,

American Bankers Association

Association of Military Banks of America

Consumer Bankers Association

Financial Services Roundtable

Independent Community Bankers of America

The **American Bankers Association** brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

Founded in 1959, the **Association of Military Banks of America** (AMBA) is a not for profit association of banks operating on military installations, banks not located on military installations but serving military customers, and military banking facilities designated by the U.S. Treasury. The association's membership includes both community banks and large multinational financial institutions, all of which are insured by the Federal Deposit Insurance Corporation.

The **Consumer Bankers Association** is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments and deposits. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation / regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

The **Financial Services Roundtable** represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for \$66.1 trillion in managed assets, \$1.1 trillion in revenue, and 2.5 million jobs.

The **Independent Community Bankers of America** represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than \$908 billion in assets, \$726 billion in deposits, and more than \$619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

## **Appendix 1**

### **Sample Memorandum of Understanding**

**MEMORANDUM OF UNDERSTANDING  
BETWEEN  
[STATE AGENCY]  
AND THE  
THE OFFICE OF THE COMPTROLLER OF THE CURRENCY**

[State Agency] (“[State Agency]”) and the Office of the Comptroller of the Currency (OCC) (each, the “Agency;” collectively, the “Agencies”) are entering into this Memorandum of Understanding (“MOU”) to enhance their communication and exchanges of information to achieve prompt and effective resolution and redress of consumer complaints relating to the financial institutions and their financial affiliates that the Agencies respectively supervise, examine or regulate (“Regulated Institutions”).

The Agencies recognize that issues may exist concerning the scope of the respective jurisdiction of each of the Agencies to supervise, examine or regulate certain Regulated Institutions. Nothing in this MOU is intended to or shall be construed to affect, modify, or imply any conclusion regarding the jurisdiction or authority of either of the Agencies or affect the rights, powers or obligations of the Agencies under existing law concerning the scope of the respective jurisdiction of each of the Agencies to supervise, examine, or regulate or bring administrative or judicial enforcement proceedings against the Regulated Institutions covered by this MOU. Nothing in this MOU shall be construed to prevent either Agency from taking any supervisory, examination, regulatory or enforcement action that the Agency may deem necessary or appropriate to carry out its responsibilities as permitted by applicable law.

Pursuant to the foregoing, this MOU is made and entered into as of \_\_\_\_\_, \_\_\_\_\_, between the OCC and [State Agency].

**1. Complaint Referrals and Information Sharing**

To the extent permitted by applicable law, including but not limited to the Right to Financial Privacy Act<sup>27</sup> and the Privacy Act,<sup>28</sup> the OCC agrees to refer to [State Agency] consumer complaints and allegations of violations of consumer protection laws concerning Regulated Institutions it concludes are subject to the jurisdiction of the [State Agency], and [State Agency] agrees to refer to the OCC consumer complaints and allegations of violations of consumer protection laws concerning Regulated Institutions it concludes are subject to the jurisdiction of the OCC. The Agencies agree to explore means to enhance processes and procedures for such sharing and to facilitate the sharing of information concerning the status and resolution of complaints and actions taken based on complaints or evidence of alleged violations of consumer protection laws referred by an Agency to the other Agency.

In order to accomplish substantive information sharing, [if requested by [State Agency],] the OCC agrees to submit to [State Agency] a written quarterly report of

---

<sup>27</sup> 12 U.S.C. §§ 3401 – 3422.

<sup>28</sup> 5 U.S.C. § 552a.

referrals received from the [State Agency] that either are not in closed status or that have been closed since the last written report setting forth the following based upon the OCC's Consumer Assistance Group (CAG) database:

- the name of the consumer,
- the identifying number assigned to the complaint by the CAG,
- bank name,
- date opened,
- date closed,
- category of case (such as loan, credit card, or deposit account) and specific laws or regulations involved,
- case status, and
- resolution (including any compensation amount).

The current status of the referral will contain the following types of information, using CAG data elements, as appropriate:

- Complaint is under review by the OCC;
- Complaint is pending, including pending response from the bank or additional information from the consumer;
- Complaint has been referred to another federal or state agency;
- Complaint has been withdrawn; and
- Complaint has been closed, including information on the date closed and final disposition of the complaint.

The OCC will provide [State Agency] with information explaining the terminology used in the data elements provided under this agreement.

Likewise, if requested by the OCC, [State Agency] agrees to submit to the OCC a written quarterly report of referrals received from the OCC that contains similar data as that described above to the extent that such a report can be generated with reasonable effort based on databases maintained by or on behalf of [State Agency].

## 2. Confidentiality

(a) For purposes of this MOU, any of the following information obtained by a Requesting Agency shall be treated as Confidential Information:

(i) the name, address, or other personally identifiable information relating to any consumer; and

(ii) any supervisory determinations by the Responding Agency, including the findings, resolution, and compensation amount relating to any complaint.

(b) The Requesting Agency agrees to use any Confidential Information it receives pursuant to this Memorandum only for purposes directly related to the exercise of its regulatory authority. The Requesting Agency may not make any additional use, or disclosure, of Confidential Information without the prior approval of the Responding Agency which shall not be unreasonably denied.

(c) All Confidential Information provided pursuant to this Memorandum belongs to, and shall remain the property of, the Responding Agency. The Requesting Agency shall also take all actions reasonably necessary to preserve and protect any privilege or claim of confidentiality relating to Confidential Information, including:

(i) restricting access to Confidential Information obtained pursuant to this Memorandum to only those of its officers, employees, or agents (including outside counsel, accountants, and consultants) who have a *bona fide* need for such information in carrying out the supervisory responsibilities of the Requesting Agency;

(ii) informing those of its officers, employees, or agents who are provided access to such Confidential Information of the Requesting Agency's responsibilities under this Memorandum; and

(iii) establishing appropriate physical safeguards for maintaining such Confidential Information.

(d) If the Requesting Agency receives a request from a third party for Responding Agency Confidential Information, or is served with a subpoena, order, or other process requiring production of such information, the Requesting Agency shall:

(i) immediately notify the Responding Agency and provide to it copies of such request, subpoena, order, or other process as well as attachments thereto;

(ii) provide the Responding Agency the opportunity to take whatever action it deems appropriate to preserve, protect, and maintain the confidentiality of such information or any related privileges;

(iii) cooperate fully with the Responding Agency to preserve, protect, and maintain the confidentiality of such information or any related privileges;

(iv) Except with respect to requests under the \_\_\_\_\_ State freedom of information law, notify the party seeking the information that it was obtained from and is considered the property of the Responding Agency and that requests for such information must be made directly to the Responding Agency in accordance with applicable federal or state law;

(v) resist, to the extent practicable, production of such information, pending receipt of written consent from the Responding Agency to the production of that information; and

(vi) consent to any application by the Responding Agency to intervene in any action to preserve, protect, and maintain the confidentiality of such information or any related privileges.

(e) Nothing in this Memorandum shall prevent the Requesting Agency from complying with a legally valid and enforceable order by a court, adjudicatory body, or legislative body of competent jurisdiction compelling production of Confidential Information, providing that the Requesting Agency:

(i) reasonably determines that efforts to quash, appeal, or resist compliance with the order would be unsuccessful;

(ii) attempts, to the extent practicable, to secure a protective order to preserve, protect, and maintain the confidentiality of such information or any related privileges; and

(iii) immediately notifies the Responding Agency of its intent to comply with the order and of any actions taken in compliance with the order.

In complying with the request, the Requesting Agency will use its best efforts to obtain from the requestor a commitment to maintain the confidentiality of the information and advise the legislative body that the information to be produced belongs to the other Agency. The Requesting Agency agrees to advise the Responding Agency as promptly as is reasonably possible of such a request prior to complying with any such request.

### 3. Miscellaneous

(a) Authority. Each party to this MOU has requisite legal authority to enter into this MOU. In the event of any material change to its authority, a party will provide written notification to the other party within ten (10) calendar days of any such change.

(b) Termination. Either party may terminate this MOU with respect to prospective sharing of information by providing thirty (30) calendar days advance written notice to the other party. In the event of termination, information obtained by a Requesting Agency under this MOU, if not returned, will remain the property of the

Responding Agency and the Requesting Agency will continue to observe all terms and conditions of this MOU that relate to such information.

(c) Agency Contacts. As soon as practicable after execution of this MOU, each Agency will advise the other of the name, title, and contact information, including addresses and telephone and fax numbers, for the appropriate official(s) to contact for purposes of notices and exchanges of information hereunder. This contact information will be updated as appropriate.

OFFICE OF THE COMPTROLLER OF  
THE CURRENCY

[STATE AGENCY]

By:

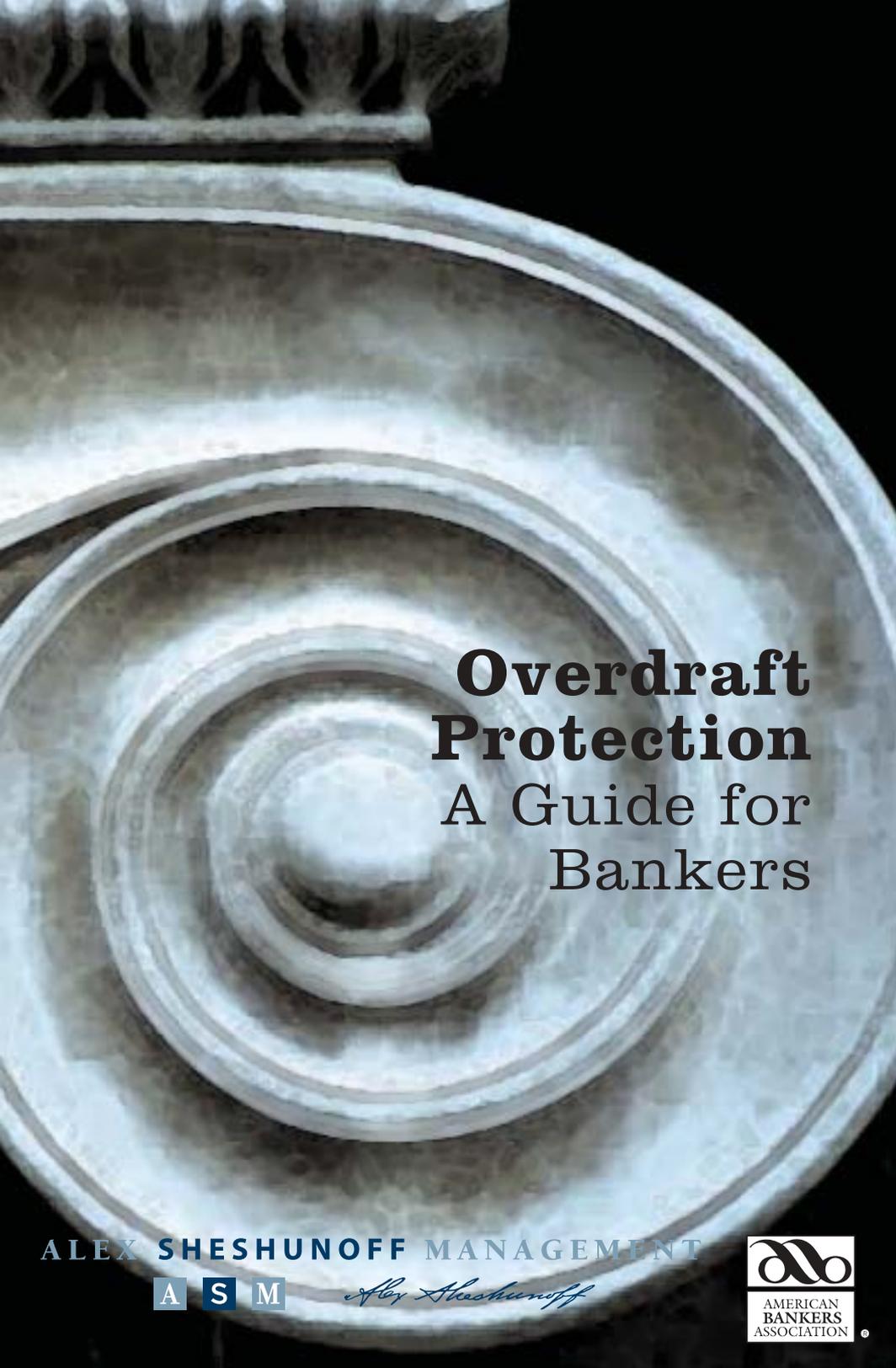
By:

\_\_\_\_\_  
[Name]  
[Title]

\_\_\_\_\_  
[Name]  
[Title]

## **Appendix 2**

### **Overdraft Protection: A Guide for Bankers**



# Overdraft Protection

A Guide for  
Bankers

ALEX SHESHUNOFF MANAGEMENT



*Alex Sheshunoff*



AMERICAN  
BANKERS  
ASSOCIATION





**Overdraft  
Protection**  
A Guide for  
Bankers



## Table of Contents

A Guide for Bankers	7
How Formalized Overdraft Protection Programs Work	10
Why Are More Bankers Considering Formalized Overdraft Protection?	12
Common Concerns	13
Addressing the Regulatory Concerns	16
Recommended Best Practice “Do’s and Don’ts”	18
Concluding Remarks	21
Appendix	23



## OVERDRAFT PROTECTION A GUIDE FOR BANKERS

Opinions about about overdraft services – those formalized systems handling Non Sufficient Funds (NSFs) presented on a customer's account. Nessa Feddis, Senior Federal Counsel of the ABA, offers her insights in a recent article stating “the basics of bounce protection are sound.”<sup>1</sup> At the same time, the Consumer Federation of America asserts that financial organizations are deliberately enticing consumers to write bad checks.<sup>2</sup> Vendors of overdraft programs extol their “customer-oriented” virtues, while the news media present overdraft users as pictures of despair. CEOs of some financial organizations tout the benefits to their customers, while others disparage the practice. Some banking organizations sign deals with vendors to endorse the programs, while a few publish negative opinions about them.

With this wide range of opinions, it is no wonder that many, inside the industry and out, question the practice and/or the methods of overdraft services. As a financial executive, how are you to approach overdraft services in order to best serve your customers, shareholders, and the public welfare?

Offering an overdraft protection program is a decision unique to each executive and organization. However, sometimes lost in the heat of the debate is the clarity created from a common set of facts. Concerns and fears grow in the absence of facts. Legitimate questions exist about overdraft services, and they deserve an analytical answer. Why has the overdraft issue arisen so fervently now and not 20 years ago? What are the benefits or reasons for a formalized overdraft program at your financial institution? What are the regulatory compliance components? What are recommended best practices, and what practices should be more cautiously considered or even avoided? Furthermore, concerns of the media and consumer groups alike have made it clear that there are definitely potential risks associated with overdraft programs, in the event the bank makes a mistake or “over-reaches” in the implementation.

Before making a decision, each bank should review any program being considered with a critical eye towards what is “right” for the customer and the bank. We hope that this guide will equip you with the background and knowledge you need to make the right decision for your bank.

<sup>1</sup> Nessa Eileen Feddis, “Will We Kill a Useful Service?” *ABA Banking Journal*, April 2003, 42.

<sup>2</sup> Consumer Federation of America and National Consumer Law Center, “Bounce Protection: How Banks Turn Rubber into Gold by Enticing Consumers to Write Bad Checks,” 27 Jan. 2003, <<http://www.consumerfed.org/bounceappendix012803.pdf>> (17 September 2003), Section 6.

## **The Origins of the “Late Payment” Choice**

Overall, consumer perceptions about debt and late payments are changing. A few years ago, some consumers counted on “float” to carry them through times when they might have been low on funds between paychecks. Over the past few years, float has been considerably decreased due to improved automation of processing systems, the increased usage of Internet banking, and the requirements of the Expedited Funds Availability Act. The increased time to clear a check that so many counted on before is no longer there.

Currently, on most of the bills that consumers pay on a monthly basis, the recipient is given the opportunity to pay the bill on time for one amount and late for a different (higher) amount. Consumers who choose to utilize the late payment option are aware of the late fee they will pay for this service. While one could certainly argue that this is financially imprudent, it is a choice that many make on a monthly basis.

Utility companies such as phone, gas, water, cable, and electric providers made this adjustment towards late payments in their policies in the 1990s. Prior to their change in approach, these industries often faced customer and public policy embarrassments when they discontinued service due to lack of payment. In order to meet customers’ payment needs, they changed their approach, finding ways to serve customers who happened to be strapped for cash between paychecks. Below is a sample disclosure statement from a utility company that allows customers to pay their bills at a later date for an additional charge.

### **Sample Water Utility Policy Statement**

**Payments:**

Utility payments are due by the 15th of the month.

Utility payments can be deposited in the drop slot located in the door of the City Office.

**Late Payments:**

Payments received after the 15th of the month are considered late.

A late charge of \$25.00 will be added to any bill not paid by the 15th.

**Disconnect:**

Utilities will be disconnected if payment is not received by the last day of the month.

**Reconnect fee is \$25.00.**

To address customer needs, vendors today supply what is now well recognized by consumers: an invoice, similar to the one above, which offers one payment if paid by a certain date, and a higher amount if paid by a later date. In defining why customers paid late fees, one utility study found that a significant segment did so even though they have sufficient financial resources.<sup>3</sup>

Bankers may want to consider the way they communicate with their customers regarding overdrawn accounts. Compare the sample utility bill referenced above with the method financial institutions commonly use to communicate with their customers. Non-bank companies typically inform the consumer of their methods of handling their account in the event the consumer does not meet their obligations on time, and they communicate the fee associated with this. They do not actively entice customers to pay their bills late, but they communicate how the account will be handled should the consumer pay late. Contrast this with the communication sent out by the bank. When an item is presented to an account with insufficient funds to pay the check, the bank generally sends out a terse notice indicating that the customer did not have the funds in their account to cover the check. The communication usually indicates that, although the bank may have paid the check, the practice of falling below the minimum balance in the account is not something the bank encourages.

### **The New Dynamics of Checking Accounts and Customer Communication**

As new payment options have flourished over the past several years, the methods and means in which consumers use checking accounts have also changed. Rather than having only checks flow through their checking account, consumers now have many ways to access their funds, such as Internet access, ATM access, etc.

A by-product of having multiple delivery channels is that consumers now need better, more specific communication from financial institutions regarding use of these accounts. Financial institutions should be aware that in regard to consumers' attitudes toward late payments, the environment is changing. Banks need to be able to clearly articulate policies so that consumers can make

---

<sup>3</sup> Roger D. Colton, "Determining the Cost Effectiveness of Utility Late Payment Charges," July 1994, <http://www.fsconline.com/downloads/LATE-FEE.pdf> (17 September 2003).

informed decisions as well as understand the bank's policy regarding NSF fees when a customer mistakenly overdraws.

### **The Dilemma**

Many bankers believe that a response that discourages overdrafts is the accepted course of action. They believe that overdrafting a checking account is simply "wrong." They believe that banks should actively discourage overdrafts and they view NSF fees as "punitive" fees that are designed to discourage the activity.

Other bankers believe that most of their customers are good customers that will ultimately clear up their accounts, and that paying an insufficient item is better for the customer than returning it. While not encouraging overdrafts, these bankers believe that they are actually helping their customers avoid other fees and providing them a valuable service when they pay overdrawn items.

### **Which view is appropriate? Or more precisely, which view is appropriate for your bank?**

In many cases, these two views are not mutually exclusive. Bankers do not want to actively encourage overdrafts, but they do want to provide good customer service whenever and wherever prudent.

## **HOW FORMALIZED OVERDRAFT PROTECTION PROGRAMS WORK**

The first question you might ask is, "How do these programs work?" An example may help illustrate the programs' underlying concepts.

*John Smith is a customer at ABC Bank. John sits down to pay his bills on the 9th of the month. He gets to his credit card bill and he notices that the payment is due on the 15th, or he can wait and pay it on the 1st of the following month, in which case he will be charged a \$36 late fee. He decides to wait and pay the credit card bill late because he has an unexpected emergency expense that he needs to pay immediately. John understands "the deal" with the credit card company – they have communicated this to him with every bill. John*

*understands that he will incur the late fee, but in spite of this, he makes the decision to defer the payment.*

*John isn't sure how ABC Bank would generally handle it if he were to present an NSF check. In the past he has presented checks that were paid when funds were not available, but he has also presented some that were returned. The bank's communication in both cases was very short and did not inform John how they made their decision. As a result, John has no comfort at all as to how the bank might handle the next check he presents.*

*ABC Bank decides to begin offering a formal overdraft program. Through a variety of techniques, the bank communicates clearly with John and generally makes him aware of their decision-making process. When John is next faced with making the decision of whether or not to pay the credit card bill, he now considers his options. He can continue to pay the bill late as he has on occasion in the past, or he can go ahead and write the check to the credit card company today and have some comfort that the bank will probably pay it. He would pay the bank \$20 (their NSF fee) vs. paying the credit card company \$36.*

### **The Informed Consumer Effect**

By communicating with customers, banks that offer formalized overdraft protection programs achieve the "Informed Consumer Effect," helping participants to make an informed decision on how to utilize this service, should the need arise. Because John is given some comfort on how his check will be handled, he shifts a fee from the credit card company to the bank and pays less in fees.

Just how does a bank communicate with a customer? This is an area where bankers should proceed with caution. A non-recommended method of communicating with customers is to market the service aggressively. A few banks put up billboards, take out radio ads, and do regular monthly statement stuffers. But as the Office of the Comptroller of the Currency pointed out in Interpretive Letter 914 (IL914), this could have the appearance that the bank is attempting to entice customers to overdraw their accounts, an activity that at best is "frowned upon" by consumer groups, and at worst could be considered an unsafe practice. At a typical bank, 60% to 70% of the customer base never (or rarely) present an insufficient item, and marketing to them is wasteful.

However, an efficient, fair, and consistent process could also be considered an opportunity for clear communication to customers – a way to enhance a customer relationship. Customers are often confused by the NSF decision-making process in those banks that do not have a formalized program, since there is often inconsistency in payment of NSF items. Banks that offer a formalized overdraft program have the opportunity to establish consistent guidelines for paying NSF items and to inform and educate customers who use the service.

## **WHY ARE MORE BANKERS CONSIDERING FORMALIZED OVERDRAFT PROTECTION?**

As of January 2003, the Consumer Federation of America estimated that more than 1,000 banks in the United States use formalized overdraft protection programs, and that number is steadily growing.<sup>4</sup> Why are more bankers considering these programs?

### **1. A New Definition of Customer Service**

One of the most common complaints by consumer groups about overdraft protection services is that banks with these programs are providing “bad” customer service. Some consumer groups equate the paying of overdrafts with “payday” lending. They believe that paying an overdraft item is equivalent to taking advantage of an uninformed customer.

However, this seems to be an oversimplification of a much broader issue. Think about it from the perspective of your customers – would they consider it better customer service if the bank paid their check or returned it?

Bank employees also benefit from a consistent overdraft program that offers them guidance on how and when to cover overdraft items. Since they can now define their overdraft policy and explain it to the customer, they can offer better customer service. Defined overdraft program guidelines eliminate banker and customer confusion and lead to improved customer service.

### **2. A Way to Avoid Discriminatory Practices**

Organized overdraft protection programs formalize a process that has been han-

---

<sup>4</sup> Consumer Federation of America, “Bounce Protection,” Section 2.

dled informally and in a discretionary manner in the past, making it more equitable and consistent. In general, banks have historically paid items for some customers and not paid them for others, based mostly on a variety of factors, including account history and the relationships the customer has with the personal bankers or CSRs working in the branch. By using overdraft protection software and more efficient automation, the banks that implement these programs state that they are attempting to treat all customers more fairly.

### **3. Increased Opportunity**

When banks formalize their programs and disclose them, they learn that some customers find this to be a valuable service. These customers choose to write a check a few days before a deposit and pay the NSF fee rather than pay a late fee to the check recipient. They choose the bank option because the costs are generally lower than those imposed by the merchant or other payee, and it presents less of a hassle. Financial institutions that formalize their process and disclose it to customers allow their customers to make informed decisions for themselves.

## **COMMON CONCERNS**

Bankers need to address a number of concerns before they decide to implement such a formal overdraft program. Questions raised by the media and consumers groups alike have spawned a variety of concerns.

### **Perceptions of “Abusing” the Customer**

Media and consumer groups have voiced concerns that some overdraft protection programs are by nature deceptive and designed to take advantage of consumers. Other media reports discuss cases in which banks have allowed customers to overdraw with their ATM or debit card, at either the ATM or the point of sale, without notification that they were overdrawing the account or that they would be charged a fee. (Reg DD requires fee disclosure at account opening and on periodic statements.)

It is interesting to note that in most overdraft discussions the media and consumer groups often gloss over individual consumer responsibility. Banks only charge these fees to consumers that present NSF items. Overdrawing is a dis-

cretionary activity and is completely avoidable, much like the decision to use a foreign ATM. In both cases, the service provided is merely responding to customer need and behavior.

Although the ultimate responsibility lies with the consumer, situations may arise in which a customer becomes overextended and is unable to pay back the overdrawn amount and subsequent fees. As customer service organizations, banks should be aware of these situations and work with the customer to resolve the issue. Any program allowing chronic overdrafts that put the customer in difficult financial circumstances may seem to take advantage of a customer and, of course, should be avoided. Banks should communicate clearly and frequently with their customers regarding the status of their account balance. The bank may then offer the overextended customer a repayment plan, perhaps at a low interest rate, or reduced NSF fees to help the customer recover from the situation. The checking account could be left open and available, as long as the customer meets their repayment obligations.

### **Appearance of Violating Credit Laws**

One recent article charged that banks are “skirting” credit laws when they pay overdrafts. The reasoning applied was that an overdraft is a short-term loan and the NSF fee imposed is interest. Some consumer advocates have stated that overdrafts amount to loans with very high interest rates, sometimes exceeding 1,000%.

These allegations ignore the fact that many banks charge the same fee whether the item is paid or returned, and there is no differential for overdrawing the account. More specifically, at most banks customers do not pay any additional fee for overdrawing their accounts – they are only charged a fee for presenting an insufficient item and the bank subsequently handling the item.

Credit laws apply when a bank extends credit to a consumer. According to the Truth in Lending Act, 15 USC 1601 et seq. (TILA) and its implementing Federal Reserve Regulation Z, 12 CFR Part 226, “Credit means the right to defer payment of a debt or to incur debt and defer its payment.” The bank does not grant a “right” to overdraw; it is a discretionary activity on the part of

the bank. Credit laws have not applied to bank overdraft fees in the past, and it is unlikely that they will in the future.

As stated in the American Bankers Association letter from ABA Chairman-Elect Ken Fergeson, dated March 21, 2003, “Overdraft protection has been around for a long time, but has evolved over the years. Under automated bounce protection systems that are now gaining in popularity, banks disclose that they may pay overdrafts up to a limit—usually between \$100 and \$500, depending on the customer. The feature is typically available to all those eligible to open an account. There is no creditworthiness test as there is for an overdraft line of credit. A flat fee is charged for the overdraft, regardless of the amount.”

Several bankers have shown hesitancy toward overdraft protection programs because of potential changes to Regulation Z (Truth in Lending), which would cause an overdraft to be considered a loan and related charges to be interest for APR purposes. For decades, under the terms of Regulation Z, regulators have not generally considered overdraft fees to be a loan when the item is paid. Prior history with other regulations has shown that the Federal Reserve changes them only after careful consideration.

Moreover, any change in regulation would likely impact the payment of all NSF items, not just those items at banks with formal overdraft programs. It would be a very detrimental change to consumers for the regulators to alter regulations in such a manner that banks could effectively no longer pay any overdrafts.

### **Incurring Too Much Risk**

It may appear upon initial review that paying overdrafts would increase the overall risk levels of a bank. After all, the customer is typically not required to complete any type of application for the service. Most banks do not subject customers to a formal underwriting process prior to allowing the customer to overdraw their account. The bank typically does not obtain credit scores.

Prudent bankers must approach an overdraft program as they would any other new product or service offering. Analysis of the particular program must be performed with the bank's overall risk tolerance in mind. Acceptable levels of risk must be determined prior to entering any program and monitored after implementation.

Most bankers who have implemented a formal overdraft program indicate that charge-offs do, in fact, increase. However, they also indicate that the overall level of charge-offs is within acceptable levels of risk and the benefits of the overdraft program outweigh the increase in charge-offs.

## **ADDRESSING THE REGULATORY CONCERNS**

Regulators have expressed concerns when reviewing overdraft protection programs, and all bankers considering this service should take care to address them. Some of the main issues are delineated in OCC Interpretive Letter 914 and further defined in the ABA letter dated March 21, 2003, from Ken Ferguson, ABA Chairman-Elect. IL914 outlines three types of regulatory concerns with respect to one particular overdraft protection program. They include: 1) Compliance Issues, 2) Supervisory Concerns, and 3) Policy Issues. We recommend studying IL914 in depth and reviewing the concerns of the OCC with legal counsel. However, there are basic steps bankers can take to be proactive in addressing these regulatory concerns.

### **Define the Process Specifically.**

For many years banks have paid checks on an inconsistent basis, often times lacking universal guidelines that employees could follow. Often, banks did not have a formal policy in place to guide bankers on how and when to cover an overdraft. Defining the process specifically will help to alleviate compliance concerns. Due to simple human nature, when paying or returning an overdraft using only personal discretion as a guide, inconsistencies will result. By applying consistent criteria across the board, the entire process should become consistently implemented with all customers.

**Use Detailed Reporting and Tracking.**

As part of the bank's formal process, the bank should use detailed reporting and tracking of accounts in the overdraft protection program. This will ensure that all levels of management remain apprised of the program, and that potential abusers of the service can be spotted and addressed appropriately, including being removed from the program.

**Avoid Statements that Seem Like Commitments.**

In all written communication to customers, be certain to stay away from statements that sound like absolute commitments to pay overdrafts (e.g., "never incur a merchant charge again"). The Office of the Comptroller of the Currency in its Interpretive Letter 914 (IL914) points out that the Federal Trade Commission Act prohibits deceptive acts or practices, including representations or omissions that are likely to mislead reasonable consumers. Carefully word all the bank's customer communications to explain the overdraft process clearly and directly. Be sure to acknowledge that the process to pay NSF's is completely discretionary and that all overdrafts will not be paid automatically.

**Avoid "Enticing" Customers to Begin Presenting NSF's.**

Studies have shown that most customers do not overdraw their accounts, nor do they want to. In 2002, Raddon Financial Group estimated that nearly 60% of customers have little or no interest in NSF services. Heavy marketing of an overdraft protection program could give the appearance that the bank is attempting to entice customers who currently do not overdraw accounts to begin overdrawing them. Aggressive marketing can potentially backfire, even though the intent may simply be to inform the customer of a helpful, new service that is now available. Instead, establish sound, customer-service response-oriented policies for customers who overdraw their accounts. Above all, do not state that overdrawing is an acceptable practice; offer alternatives. The bank should also provide appropriate disclosures at the ATM and teller window if customers are allowed to overdraw their accounts at those channels.

**Use the Same Fee for Both Paying and Returning.**

One of the "tests" offered in IL914 for determining if an overdraft fee is a finance charge or not, as stated under Regulation Z, is whether an NSF fee is the same regardless of whether a check is paid or returned. By charging the same fee in both instances, the fee is unlikely to be considered a "finance charge."

### **Utilize Effective Risk Management Techniques.**

Banks that monitor customer behavior can contact those customers who exhibit excessive or abusive usage and inform them of bank programs that can help them manage their account balances. This practice should identify customers who show a serious lack of account management so that bank management can make decisions on the customer's continued involvement in the bank's overdraft program.

## **RECOMMENDED BEST PRACTICE “DO’S AND DON’TS”**

In addition to taking proactive steps to address regulatory concerns, adhering to certain “best practices” will help ensure that an overdraft protection program takes the right approach. The main best practices that all bankers should know include:

### **Best Practice “Do’s”**

- 1. Do inform customers that the bank has other ways to handle overdrafts, such as lines of credit and automatic transfers.** Clear communication will give customers all the information they need to make an informed decision. Let your customers know that the bank has other, potentially less expensive ways to handle overdrafts.
- 2. Do proactively offer an “opt-out” giving the customers a choice.** Some customers may not want to have their items paid, and they should be given this choice. By sending each qualified customer a letter with an opt-out clause *before the program is implemented*, bankers are ensuring that all customers are duly informed and are aware of their alternatives.
- 3. Do monitor customer activity, and don't let customers abuse the service.** Utilize software tools to generate detailed reports that will allow the bank to track customers who may be abusing the privilege. Consider contacting and notifying frequent overdrafters of the cost of these services, and suggest a meeting with bank officers to consider other alternatives to overdrafting.

**4. Do apply good risk management techniques, using software to monitor usage.** IL914 notes that overdraft protection programs could increase a bank's credit risk profile (e.g., higher delinquency and loss rates) by extending credit to borrowers who may not have normally qualified for payment of overdrafts or overdraft protection. By utilizing software tools with robust reporting capabilities, you should be able to minimize this risk and manage it accordingly.

**5. Do communicate with customers often, using multiple channels (i.e., letters, phone calls, email).** It is imperative that bankers notify customers as overdrafts are presented and then continue to communicate with the customer while they are overdrawn. As ABA Senior Federal Counsel Nessa Feddis states in an April 2003 *ABA Banking Journal* article, "A consumer understanding of bank practices in this matter is *absolutely critical* to avoid charges of unfair play."<sup>5</sup> Communication and education of customers will help to dispel the mystery of the process and enhance the overall customer relationship as well.

### **Best Practice "Don'ts"**

**1. Don't use aggressive marketing.** One of the biggest red flags for regulators and consumer groups alike is a program that tries to achieve increased revenue through aggressive marketing techniques. This kind of customer communication also makes it seem as if the bank is attempting to encourage customers who have not presented NSF's to begin presenting them.

**2. Don't step over the line from a compliance perspective.** Regulators may question programs that give the wrong impression about the scope of protection offered by the program and in turn oversell its benefits. When communicating with customers, it is important to use clear, precise, and accurate language that does not attempt to oversell the customer. Keep in mind that this service is discretionary, and therefore avoid promises or words that sound like commitments to customers. 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 overly broad statements, given the limitations of these programs.

---

<sup>5</sup> Feddis, 40.

**3. Don't allow customers the opportunity to access funds that will put their account into a negative balance at the ATM, through POS, or teller window without customer knowledge. Banks should communicate clearly with their customers and disclose all fees and charges associated with transactions that will result in an overdraft status on the account.**

If bankers make the decision to allow customers to overdraw their account balance at the ATM, through POS, or teller window, if technically feasible the bank should inform the customer at the time of the transaction that they will incur an additional fee for overdrawing under the circumstances. If this is not technically feasible, the bank should place notices at the ATM or have a policy in place that does not allow the customer to overdraw the account at the ATM.

Banks should not mislead their customers as to the actual balance in their account and they should clearly present balances to their customers in a format that is easy to understand. For example, if the overdraft limit is included in an "available balance," the text on the ATM screen and receipt should specifically state that the balance includes the overdraft limit. Mistakes are easily made if this information is not communicated to the customer clearly at the time of the transaction. Additionally, banks should consider waiving any initial NSF fees for customers who inadvertently overdrew their checking account due to any type of confusion at electronic channels.

**4. Don't leave out effective risk management.** Given the loss history of bank overdraft programs, bank management should develop reasonable loss recognition guidelines and establish loan loss reserve methodologies to ensure timely loss recognition and estimated loss coverage. This is imperative. Strict loss-recognition programs and tracking are recommended.

## CONCLUDING REMARKS

With the wide range of opinions and heartfelt emotions concerning overdraft programs, it is no wonder that many inside and outside the industry question either the practice or the methods of overdraft services. In sorting through the facts and opinions, history can be an excellent guide. In the May 20, 1961, issue of *Business Week*, the headline read, “With the Fed showing no signs of easing its regulations, banks are doubting the wisdom of offering certificates of deposit.”<sup>6</sup> Believe it or not, this statement was made concerning negotiable CDs!

Even the most pedestrian of bank products today, certificates of deposit, were once the subject of much debate and concern. Consumer needs often are ahead of regulatory management and public policy. Such may be the case with formalized overdraft programs. Bankers, however, must carefully consider all sides of the formalized overdraft option to make the best decision for their banks.

---

<sup>6</sup> “Some Second Thoughts on CDs,” *Business Week*, 20 May 1961, 138.



**APPENDIX****Letter to Bank CEOs from the ABA Chairman-Elect.**

Date: March 21, 2003

To: Bank CEOs

From: Ken Fergeson, ABA Chairman-Elect

Hundreds of banks are offering automated bounce protection on checking accounts, a new version of bankers' traditional practice of paying overdrafts. Many other banks are considering it. That's why I'm writing. As ABA's Chairman-Elect and a community banker, I'm hearing a lot of concern about this product and the consequences of offering and promoting it.

All bankers want a fair return. But bankers also have a responsibility to treat customers fairly and provide them with clear, conspicuous disclosures. One misleading phrase or questionable ad can destroy your customers' trust in a heartbeat, an awfully high price to pay. As one compliance officer wrote about paying interest on investable balances, "It's cute. It's legal. Don't do it!" When put under a spotlight, that practice led Congress to enact the Truth-in-Savings Act and the Fed to issue Reg DD. That example could be a preview of coming attractions if bankers don't look carefully before they leap into this.

Consumers like overdraft protection. It can save them returned-check fees from creditors or merchants and avoid tarnishing their credit rating in credit bureaus and databases. But some of these products have drawn fire from the regulators and in the media—and litigation won't be far behind, as customers start complaining about unfair treatment.

Overdraft protection has been around for a long time, but has evolved over the years. Under automated bounce protection systems that are now gaining in popularity, banks disclose that they may pay overdrafts up to a limit—usually between \$100 and \$500, depending on the customer. The feature is typically available to all those eligible to open an account. There is no creditworthiness test as there is for an overdraft line of credit. A flat fee is charged for the overdraft, regardless of the amount.

Before you offer a bounce protection product, decide if you'd want to defend the one you're considering in your local newspaper or to your regulator. To protect yourself and your institution's reputation, you should, at a minimum:

- Disclose, disclose, disclose. Disclose costs and terms in the agreement fully and conspicuously, including treatment of debit card overdrafts. And disclose charges prominently in statements.
- Make clear that the bank is not promising to pay checks, even if the consumer meets the criteria for paying an overdraft.
- Do not encourage overdrafts in your marketing materials, advertising or communications. Some customers have bounced checks because, on balance inquiries, their bank adds the amount of their overdraft protection to their true balance, leading them to believe they have more than they do. Some bank messages encourage them to use the product anytime.
- Monitor the account for frequent use of the service. Customers may not understand how to use it appropriately.

All of these efforts may still not be enough. Done carefully, automated bounce protection programs can be good for your customers and for the banks. But without understanding how your program will be seen and judged in your community, in the agencies and in court, it could become your worst nightmare. If you offer one, proceed with caution and make sure you do it right.

If you have any questions or concerns, please contact ABA Regulatory Director Jim McLaughlin, at 1-800-BANKERS.





## BIBLIOGRAPHY

Berensen, Alex. "Some Banks Encourage Overdrafts, Reaping Profit." *New York Times*, 22 January 2003, A1.

Board of Governors of the Federal Reserve System. *Annual Report to the Congress on Retail Fees and Services of Depository Institutions*. June 2002.

Consumer Federation of America and National Consumer Law Center, "Bounce Protection: How Banks Turn Rubber into Gold by Enticing Consumers to Write Bad Checks." 27 Jan. 2003, <http://www.consumerfed.org/bounceappendix012803.pdf>, 17 September 2003.

Colton, Roger D. "Determining the Cost Effectiveness of Utility Late Payment Charges." July 1994, <http://www.fsconline.com/downloads/LATE-FEE.pdf>, 17 September 2003.

Feddis, Nessa Eileen. "Will We Kill a Useful Service?" *ABA Banking Journal*, April 2003, 38-42.

Ferguson, Ken. Letter to Bank CEOs from the ABA Chairman-Elect. 21 March 2003.

Office of the Comptroller of the Currency. *Interpretive Letter #914*. 15 USC 1691, 12 CFR 215, 12 CFR 226, SBJ CONS, September 2001.

Raddon Financial Group. "Consumer Trends in Checking Accounts," Spring 2002.

"Some Second Thoughts on CDs." *Business Week*, 20 May 1961, 138.





1120 Connecticut Avenue, N.W.  
Washington, D.C. 20036  
1-800-BANKERS ext. 7587  
www.aba.com

**A S M**

Alex Sheshunoff Management  
2801 Via Fortuna, Suite 600  
Austin, TX 78746  
1-800-477-1772  
asheshunoff.com

## Appendix 3

### Financial Literacy Efforts

#### American Bankers Association

- Since 1925, the ABA Education Foundation, a non-profit subsidiary of the American Bankers Association, has provided leadership and resources to help bankers teach children and young adults about credit, saving and budgeting.
- The ABA Education Foundation reaches out to military families through our programs and resources and through ABA's longstanding relationship with the Association of Military Banks of America. In addition, ABA Senior Counsel, John Rasmus, serves as the co-chair of the Military Saves National Partners Committee seeking to engage trade and professional associations and their members to support the Military Saves program. As an example, the ABA Education Foundation in partnership with Armed Forces Bank and the U.S. Treasury Department provided credit education directly to service members at a teaching event held at Nellis Air Force Base in October 2004. The ABA Education Foundation also has met with Barbara Thompson, Director, Office of Family Policy – Children and Youth, Department of Defense, to explore opportunities for bankers to provide savings education for military children.
- The ABA Education Foundation's "Get Smart About Credit" program assists bankers in providing credit education in their communities and provides education directly to consumers through the [www.getsmartaboutcredit.com](http://www.getsmartaboutcredit.com) Web site.

On National Get Smart About Credit Day in October, bankers visit high schools, colleges, and youth groups to teach students how to comprehend basic credit concepts (such as interest, finance charge, and balance), understand a credit report, protect personal information, and recognize the signs of credit stress and overspending before it becomes a problem. Since the program started in 2003, some 1,000 banks have taught the credit do's and don't's to more than 315,000 young adults.

Getsmartaboutcredit.com provides resources and links to credit education programs provided by banks, the ABA Education Foundation and government agencies. Programs are sorted by the intended audience – young adults, new credit users, and Latinos – to help consumers find the program that's right for them. The resources section includes a guide to using credit cards, credit card do's and don't's and financial calculators

that simplify common financial investments and transactions – all in English and Spanish.

In addition, the ABA Education Foundation provides an online, e-learning Get Smart About Credit program that bankers can use to teach credit education 24/7 in their communities.

- On National Teach Children to Save Day, held each April, thousands of bankers across the country visit classrooms to teach lessons on the concept of saving, how interest makes money grow, how to create a budget, and differentiate between needs and wants. Since this program began in 1997, more than 45,000 bankers have taught savings skills to nearly 2.3 million young people.

The ABA Education Foundation also supports America Saves Week and serves on the Board of the Jump\$tart Coalition for Personal Financial Literacy, an organization dedicated to increasing financial management instruction in our nation's schools.

- The ABA has prepared and makes available the “Guide to Credit Cards,” which informs consumers about how to select and use credit cards.
- The ABA Education Foundation provides other resources to help bankers teach financial education in their local areas. Those resources include:
  - **The ABA Financial Education Toolbox:** Free to ABA members, this four-book guide contains tips, case studies, and lesson plans to help bankers start or enhance a financial education program.
  - **Money Talks Newsletter:** This free resource contains practical advice, thought-provoking ideas, and simple activities for teaching young people about money. Bankers provide the newsletters – available in English and Spanish – through their branches and through partnerships with community groups.
  - **ABAEF.com web site:** The ABA Education Foundation web site offers financial education resources and tips for bankers and, for consumers, financial calculators and tips on personal finance, banking services, and consumer protection.
  - **Financial Education Booklet Series:** The ABA Education Foundation provides simple, easy-to-read pamphlets in English and Spanish on credit, checking accounts, saving, and budgeting. Bankers offer the booklets to new graduates, seasonal workers, and others through their community outreach activities.

## Financial Services Roundtable Resources

- **My Money Management:** This website ([www.mymoneymanagement.net](http://www.mymoneymanagement.net)) is a collaborative effort by the financial services industry to provide consumers with access to financial information and educational tools to help in managing their personal finances. The goal of this website is to provide consumers with sound resources from a variety of sources, including financial services companies, advocacy organizations, and personal finance experts. There is also an extensive section in Spanish.
- Financial Fitness Tips – created by the Roundtable’s Council on Consumer Finance, three financial tips booklets have been disseminated throughout the nation. The topics covered are: “In Debt? Worried? Some Steps You Can Take”; “Do You Have a Game Plan? Tips for Maintaining Financial Health”; and “Having Trouble Paying Your Mortgage? Tips for Homeowners Facing Foreclosure”.
- In the Roundtable’s 2007 Community Build Day, member companies sponsored 116 back-to-school drives and 25 financial education programs. This year, the Roundtable’s Community Service 2008 focuses on financial education programs

**ICBA Financial Literacy Resources** (as found at <http://www.icba.org/consumer/index.cfm?ItemNumber=11331>)

ICBA Supports the FDIC Money Smart Program



[ICBA/FDIC Press Release](#)(PDF format - 109KB)

For more information on Money Smart, click on the FDIC logo for more information.

To receive your free Money Smart CD, please contact ICBA at [marketing@icba.org](mailto:marketing@icba.org).



Wall Street Journal Classroom Edition Program

## ICBA and Operation Hope Promote Financial Literacy

[News Release / View Photos](#)

[Emergency Financial First Aid Kit](#)

**ICBA has also compiled the following listing of other Financial Literacy programs:**

- Evaluating Your Financial Literacy Program (Woodstock Institute):  
[http://www.woodstockinst.org/component/option,com\\_docman/Itemid,0/task,doc\\_download/gid,41/](http://www.woodstockinst.org/component/option,com_docman/Itemid,0/task,doc_download/gid,41/)

## Online Programs for Children

- Banking Is: [www.bankis.com](http://www.bankis.com).
- Banking on Kids (bank within-a-school program, K-8):  
[www.bankingonkids.com](http://www.bankingonkids.com)
- Cemark: [www.cemarkinc.com](http://www.cemarkinc.com).
- FED101 (an interactive Federal Reserve System economic education Web site using Flash technology): [www.kc.frb.org/fed101](http://www.kc.frb.org/fed101).
- Federal Reserve Kids Page: [www.federalreserve.gov/kids/default.htm](http://www.federalreserve.gov/kids/default.htm).
- JumpStart: [www.jumpstart.org](http://www.jumpstart.org).
- Kid Savers: [www.kidsaversnetwork.com](http://www.kidsaversnetwork.com)
- KidzBANK: [www.kidzbank.com](http://www.kidzbank.com).
- Money Central Station (U.S. Treasury Department animated site with activities for children): [www.bep.treas.gov/kids/start.html](http://www.bep.treas.gov/kids/start.html).

- Save for America: [www.saveforamerica.org](http://www.saveforamerica.org).
- Saving Makes Cents (Massachusetts State Treasurer): [www.state.ma.us/treasury/smc.htm](http://www.state.ma.us/treasury/smc.htm).
- Social Security Kids Stuff (Social Security Administration): [www.ssa.gov/kids/kids.htm](http://www.ssa.gov/kids/kids.htm).
- U.S. Treasury kids' programs and other resources: [www.treas.gov/kids](http://www.treas.gov/kids).

### Online Programs For Teens and Adults

- The British Museum: (a look at money beginning with its earliest known minting (650-600 BC). International perspective: [www.thebritishmuseum.ac.uk/worldofmoney/world\\_studying.html](http://www.thebritishmuseum.ac.uk/worldofmoney/world_studying.html)
- Chicago Fed On Reserve: a resource for economic educators: [www.chicagofed.org/publications/onreserve/index.cfm](http://www.chicagofed.org/publications/onreserve/index.cfm).
- Choose to Save: [www.choosetosave.org](http://www.choosetosave.org).
- FDIC's Money Smart curriculum: [www.fdic.gov/consumers/consumer/moneysmart/index.htm](http://www.fdic.gov/consumers/consumer/moneysmart/index.htm)
- Financial Literacy & Education Commission: <http://www.mymoney.gov>
- OCC Financial Literacy Resource Directory: [www.occ.treas.gov/ftp/advisory/2001-1a.pdf](http://www.occ.treas.gov/ftp/advisory/2001-1a.pdf).
- Freddie Mac's Credit Smart: [www.freddiemac.com/creditsmart/home.html](http://www.freddiemac.com/creditsmart/home.html).
- Guide to Financial Literacy Resources (Federal Reserve Bank of San Francisco, 32 pages): [www.frbsf.org/community/webresources/bankersguide.pdf](http://www.frbsf.org/community/webresources/bankersguide.pdf).
- Institute of Consumer Financial Education: [www.financial-education-icfe.org](http://www.financial-education-icfe.org).
- Investing for Success (A partnership of the National Urban League, Coalition of Black Investors-Investment Education Fund and the Investment Company Institute Education Foundation): [www.icief.org](http://www.icief.org).
- Latino Financial Issues Program (UT at San Antonio and Arizona State U): [www.national-lfip.org](http://www.national-lfip.org)
- Maryland Public Television: [www.mpt.org/senseanddollars](http://www.mpt.org/senseanddollars)
- MyMoney.Gov: Financial Preparedness for Potential Natural Disaster: [www.mymoney.gov/katrinainfo.shtml](http://www.mymoney.gov/katrinainfo.shtml)

- National Council on Economic Education, programs for school age thru adult: [www.ncee.net](http://www.ncee.net)
- National Endowment for Financial Education (program for high school): [www.nefe.org](http://www.nefe.org).
- Northwestern Mutual Life Insurance Co. and the National Council of Economic Education: [www.themint.org](http://www.themint.org)
- Savings Tools (American Savings Education Council) includes various calculators: [www.asec.org/toolshm.htm](http://www.asec.org/toolshm.htm)
- Young Americans Center for Financial Education: [www.yacenter.org](http://www.yacenter.org).
- Visa program: [www.practicalmoneyskills.com/index.php](http://www.practicalmoneyskills.com/index.php).
- Young Money, from InCharge<sup>®</sup>; Institute of America, Inc., a national non-profit organization specializing in personal finance education and credit counseling <http://www.youngmoney.com/>

### **Consumer Bankers Association**

The Consumer Bankers Association (CBA) has been actively promoting financial literacy through conferences and educational activities.

Currently, CBA is working with the Ad Council and the Leadership Conference on Civil Rights to develop a financial literacy campaign to provide consumers with the tools they can use to improve their credit. The campaign, expected to kick off this Spring, will include public service announcements on television and radio, in English and Spanish. The PSAs will focus on specific suggestions for improving the management of credit in order to raise credit scores (such as paying bills on time and not “maxing out” on credit cards). They will also refer people to a comprehensive web site that will provide useful information and activities that can assist in promoting better credit.