

**Comments to the
Office of the Comptroller of the Currency (OCC)**

**Docket ID OCC-2011-0012
76 Federal Register 33409 (June 8, 2011)**

***Proposed Guidance
on
Deposit-Related Consumer Credit Products***

by

**Center for Responsible Lending
Consumer Federation of America
National Consumer Law Center, on behalf of its low-income clients**

August 8, 2011

The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund.

SHCU has operated a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. In 2008, Self-Help founded SHFCU to expand Self-Help's mission. CRL has consulted with Self-Help's credit unions in formulating these recommendations.

Consumer Federation of America (CFA) is a nonprofit association of some 300 national, state, and local pro-consumer organizations created in 1968 to represent the consumer interest through research, advocacy, and education.

The National Consumer Law Center (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit.

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I. Introduction

Over the last ten years, federal regulators have recognized the abuses of payday lending and have taken effective steps to prevent banks from partnering with companies that made these loans. However, in recent years, banks have begun offering these payday loans themselves directly through bank accounts, with the same devastating consequences for families. Banks have also increasingly engaged in abusive overdraft practices; whereas overdraft began as an occasional courtesy, it now operates like payday lending, as a high-cost debt trap. Notably, these overdraft abuses have become widespread, notwithstanding guidance by the OCC and other regulators that recognized these problems and advised banks not to engage in these practices.

The OCC has proposed new guidance for bank payday loans and for overdraft practices. The challenge is how this guidance can actually bring reform to current abuses. It may, like the earlier overdraft guidance, provide little or no improvement. At worst, it could legitimize abusive practices by providing standards that do not address the core abuses and imply they can continue if small protections are added.

In the case of bank payday loans, banks should not be participating in or offering this product. Its destructive impact on customers has been long documented—that is why regulators prohibited banks from partnering with payday lenders. It defies logic for banks to be authorized to make these loans themselves. Now—while only a handful of financial institutions are making payday loans—is the time for the OCC to end the abuse before it becomes pervasive.

Payday loans have several key characteristics that create a high cost debt trap: required lump sum repayment on the next deposit rather than affordable installments; triple-digit interest rates and fees that are far above established standards; lending based on an asset (the bank account) rather than an underwritten ability to repay; and automatic debit of bank accounts, even those with exempt funds. Extensive experience with state payday lending clearly shows that all of these deficiencies must be corrected to prevent the debt trap. That experience also has demonstrated that cosmetic provisions such as cooling off periods or installment options are ineffective and actually entrench bad practices.

Overdraft was never intended as a credit product but has devolved to operate like payday lending. Effective reform must address several key features: transaction order must not be manipulated to inflate overdraft fees; no fees should be charged on debit card and ATM transactions; fees should be reasonable and proportional to the amount of the underlying transaction and to the cost to the bank of covering the overdraft; and overdraft fees should be limited to six fees per year, after which overdraft acts as a longer-term credit product subject to responsible credit standards.

High-cost loans like payday and overdraft erode the assets of bank customers and, rather than promoting savings, make checking accounts unsafe for many customers. They lead to uncollected debt, bank account closures, and greater numbers of unbanked Americans—all

outcomes inconsistent with the safety and soundness of financial institutions. By making these loans, banks also harm legitimate lenders and other legitimate businesses by putting themselves first in line for payment of debt and leaving their customers financially worse off. The reputation risks these products pose further undermine banks' safety and soundness.

The proposed guidance articulates several principles, including credit based on ability to repay and prudent limitations on cost and usage. But for the proposed guidance to address existing problems and to not inadvertently entrench abuses, it must be revised in significant ways, as described in these comments. With these revisions and vigorous enforcement by the OCC, important reform can be achieved. Without both, the dismal experience of the previous overdraft guidance will be repeated.

Key recommendations:

The OCC's proposal is "predicated on the premise that bankers should provide customers with products they need, and that bankers should not use these products to take advantage of their customer relationship."¹ We agree with this statement and urge the OCC to require that banks offer only responsible products that are not structured in a way that traps many customers in debt.² If banks cannot offer customers credit on responsible terms, they should not extend them unaffordable debt. More specifically, our recommendations are as follows:

- **Payday lending:**
 - The OCC should take immediate supervisory and/or enforcement action to stop Wells Fargo, U.S. Bank, Guaranty Bank and Urban Trust Bank from making unaffordable, high-cost payday loans. The OTS recently shut down MetaBank's iAdvance payday program, citing unfair and deceptive practices (UDAP). We expect that the OTS's UDAP concerns related to product features shared by the very similar payday loans being made by OCC-supervised banks. The OCC should take similarly strong action immediately, even prior to finalization of its proposed guidance.
 - In the alternative, the OCC should impose an immediate moratorium on the bank payday product (stopping it at the banks offering it and prohibiting it at additional banks) while collecting data to evaluate the appropriateness of the product, including the amount and source of

¹ Department of the Treasury, Office of the Comptroller of the Currency, Proposed Guidance on Deposit-Related Consumer Credit Products, Docket ID OCC-2011-0012, June 8, 2011, 76 Fed. Reg. 33409, 33410 [hereinafter OCC Proposed Guidance].

² See FDIC Financial Institution Letters, *Affordable Small Dollar Loan Products, Final Guidelines*, FIL-50-2007 [hereinafter FDIC Affordable Small Loan Guidelines], (June 19, 2007).

borrowers' income, frequency of use and rollovers, impact on people of color, impact on overdraft and nonsufficient funds (NSF) fees, impact on account closures, and the cost to the institution of making payday loans.

- With respect to the guidance itself, the OCC should require that loans:
 - be repaid in affordable installments, rather than in lump sums. The OCC's 2000 payday lending guidance highlighted concerns about multiple renewals, noting that "renewals without a reduction in the principal balance . . . are an indication that a loan has been made without a reasonable expectation of repayment at maturity."³ Yet the OCC's suggestions to address repeat use—installment options and cooling off periods—have been shown at the state level to be entirely ineffective. *Affordable installments at the outset are essential to avoiding multiple renewals.*
 - be reasonably priced, where cost of credit is expressed as an interest rate and any fees are reasonable;
 - be underwritten based on an ability to repay, without needing to take out another loan shortly thereafter. In its proposal, the OCC does not address a central concern about borrowers' ability to repay small-dollar loans: that *meaningful* ability-to-repay means being able to repay *without taking out another loan shortly thereafter*.
 - not be repaid through automatic setoff against the customer's deposits (and especially when those are exempt funds), consistent with the prohibition on wage garnishments in the Credit Practices Rule and with Treasury's interim final rule regarding delivery of Social Security benefits to prepaid debit cards.
- **Overdraft practices:**
 - The OCC must explicitly prohibit posting transactions in order from highest to lowest.
 - The OCC should require that banks minimize fees through posting order whenever feasible.

³ OCC Advisory Letter on Payday Lending, AL 2000-10 (Nov. 27, 2000) [hereinafter OCC Advisory Letter on Payday Lending].

- The OCC should prohibit overdraft fees on debit card and ATM transactions, which can easily be declined at no cost.
- The OCC should require that overdraft fees be reasonable and proportional to the amount of the underlying transaction and to the cost to the bank of covering the overdraft.
- The OCC should limit overdraft fees to six per year, consistent with the FDIC’s recent recognition that charging more than six overdraft fees per year is excessive.⁴
- The OCC should monitor overdraft programs closely and rigorously collect data to facilitate its enforcement of the guidance.
- Even prior to finalization of this guidance, the OCC should heighten enforcement of the 2005 Joint Guidance on overdraft programs. Despite its weaknesses, including regarding transaction posting order, that guidance does call on banks to monitor excessive use; to consider limiting overdraft programs to checks, i.e., excluding debit card and ATM transactions; and to ensure compliance with the Equal Credit Opportunity Act.

Affirmative consent should be a baseline requirement for any credit product for both new and existing customers, but it is not an effective remedy against abusive practices—and often provides cover for abuses—as evidenced by continued overdraft abuses in the wake of opt-in requirements and long-time abuses in the payday, credit card, and mortgage markets, where consent requirements have been the norm.

Finally, the OCC should require that banks comply with the letter and the spirit of federal and state consumer protection laws, which aim to protect customers from many of the abusive features characteristic of payday and high-cost overdraft loans.

In Part II of this comment, we provide an overview of the bank payday loan product and related issues (Sections A through H), followed by discussion of our key recommendations addressing payday loans (Section I.1), followed by a more detailed discussion of the OCC’s proposed guidance as it relates to payday loans (Section I.2). In Part III, we provide an analogous discussion of overdraft loans, including an overview of the product and related issues (Sections A-B), followed by our key overdraft recommendations (Section C.1), followed by a more detailed analysis of the OCC’s proposal as it relates to overdraft (Section C.2). Finally, in Part IV, we discuss, and urge the OCC to enforce, the

⁴ For any brief period during which payday lending by banks may continue, this limit should apply to overdraft and payday loans combined.

various state and federal consumer protection laws that are implicated by both payday and overdraft practices.

II. Payday Loans By Banks

A. The OCC Did Not Tolerate National Banks' Partnerships With Payday Loan Shops in the Late 1990s.

A decade ago, several national banks were partnering with storefront payday lenders in so-called rent-a-bank schemes that allowed storefronts to rely on a national bank charter to evade state small loan laws. The OCC responded, issuing guidance addressing concerns that payday lending “can pose a variety of safety and soundness, compliance, consumer protection, and other risks to banks.”⁵ This guidance also referenced the OCC’s general guidance on abusive lending, which identifies the following indicators of abusive lending, all of which are characteristic of payday loans:

- pricing and terms that far exceed the cost of making the loan;
- loan terms designed to make it difficult for borrowers to reduce indebtedness;
- loans based on the ability to seize collateral rather the ability to make scheduled payments in light of the borrower’s resources and expenses;
- high fees;
- loan flipping, i.e., frequent and multiple refinancings;⁶ and
- balloon payments.⁷

The OCC inspected the four national banks that were partnering with storefront payday lenders and brought enforcement actions in each case to terminate those partnerships. No national banks have entered the “rent-a-bank” payday loan sector since.⁸

There is no reason that the OCC should allow banks to do themselves, to their own customers, what it would not allow them to do through partnerships with storefront payday lenders.

⁵ OCC Advisory Letter on Payday Lending.

⁶ In the mortgage context, an originator sells the borrower an unaffordable loan only to later refinance the borrower into another unsustainable loan, extracting fees and stripping home equity from the borrower in the process. In the context of payday lending, cash is stripped from the deposits of borrowers who are flipped. The lender extends a series of payday loans to the customer that the customer cannot afford to repay without being extended a new loan.

⁷ OCC AL 2000-7 on Abusive Lending Practices. *See also* OCC AL 2002-3 on Predatory and Abusive Lending Practices.

⁸ OCC, Annual Report, Fiscal Year 2003, p. 17. *See also*, Jean Ann Fox, “Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury,” Consumer Federation of America, March 30, 2004 at 17.

B. Payday Loans by Banks are a Growing Problem, and the OCC’s Guidance May Facilitate Further Growth.

A few large banks and at least two smaller thrifts are making payday loans. For customers with direct deposit of wages or public benefits, the bank will advance the pay in increments for a fee. The bank deposits the loan amount directly into the customer’s account and then repays itself the loan amount, plus the fee, directly from the customer’s next incoming direct deposit. If direct deposits are not sufficient to repay the loan within 35 days, the bank repays itself anyway, even if the repayment overdraws the consumer’s account, triggering more fees. For more details on the terms of the product, *see* Appendix A.

These loans are structured just like loans from payday shops, where borrowers typically are stuck in multiple payday loans per year: Usually borrowers take out several loans in quick succession with a new fee each time because they cannot afford to repay the loan in full, plus the fee, *and* meet ongoing expenses until their next deposit. Shortly after repaying the previous loan, they require another loan.⁹ This cycle of debt causes grave consequences for consumers, discussed further in Section E below.

In a replay of the growth in overdraft programs (described in Section III.A below), consultants now are actively pushing bank payday loans, touting dramatic increases in fee revenue. A recent industry webinar recommended that banks consider issuing high-cost, triple-digit APR loans,¹⁰ and payday loan software is being marketed to banks with promises that within two years, revenue from the product “will be greater than all ancillary fee revenue combined.”¹¹ Bank payday programs are not pushed as a way to *substitute* for overdraft fees; rather, they promise to be an additional way for banks to generate revenue. One marketing flier promises that offering the payday loan product will result in little-to-

⁹ See Leslie Parrish and Uriah King, *Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76 percent of total volume*, Center for Responsible Lending (July 9, 2009) [hereinafter *Phantom Demand*], available at www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf. This research highlights that among the large majority of payday borrowers with multiple loans, nearly 90 percent of all new loans are taken during the same pay period in which the previous loan was repaid.

¹⁰ Overdraft Rules, Part II: Interpreting the Ambiguous Guidance, Web Seminar, Banking Technology News, February 8, 2011.

¹¹ Fiserv Relationship Advance program description, available at <http://www.relationshipadvance.com/>; see also Fiserv unveils Relationship Advance: *Full-service solution provides a safer, more cost-effective alternative to courtesy overdraft programs*, Press Release (Nov. 18, 2009), available at <http://investors.fiserv.com/releasedetail.cfm?ReleaseID=425106>; Jeff Horwitz, *Loan Product Catching On Has a Couple of Catches*, American Banker, Oct. 5, 2010.

no “overdraft revenue cannibalization.”¹² Indeed, prior research has found that non-bank payday loans often exacerbate overdraft fees.¹³

Bank payday loans have already caught on with several banks, which combined hold approximately 13 percent of total deposits at national banks and savings institutions.¹⁴ Four of these institutions—Wells Fargo, US Bank, and since the dissolution of the OTS, Guaranty Bank and Urban Trust Bank—are OCC-supervised institutions.¹⁵ These banks are making loans in at least eight states with interest rate or other significant limits on non-bank payday loans.¹⁶ At least one of these institutions may soon roll the product out in additional states that prohibit non-bank high-cost lending.

Some banks are also offering payday products through prepaid cards. MetaBank was offering a high-cost line of credit (called “iAdvance”) to customers who had their wages or public benefits deposited onto a prepaid card. The bank repaid itself automatically when the next direct deposit to the card was made. The OTS shut that product down earlier this year, finding that bank had engaged in unfair and deceptive practices in connection with the product.¹⁷

Nonetheless, prepaid card payday loans may continue and are on the verge of expanding. Urban Trust Bank, an OCC-regulated thrift, makes payday-like loans through prepaid cards sold by Arizona check cashers, ignoring Arizona usury caps, and possibly in other states.¹⁸ Urban Trust also had an account advance product on the Elastic prepaid card

¹² Fiserv Relationship Advance program description, available at <http://www.relationshipadvance.com/>.

¹³ See Center for Responsible Lending, *Payday Loans Put Families in the Red*, Research Brief, February 2009 [hereinafter *Payday Loans Put Families in the Red*], available at <http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf>.

¹⁴ Based on total bank and savings institutions deposits of \$9.4 trillion for 2010, as reported by the FDIC’s *Statistics on Depository Institutions*.

¹⁵ See discussion of the product offered by Wells Fargo at <https://www.wellsfargo.com/checking/dda/>; US Bank at http://www.usbank.com/cgi_w/cfm/personal/products_and_services/checking/caa.cfm; and Guaranty Bank at <http://www.guarantybanking.com/easyadvance.aspx>. See also terms of Urban Trust Bank’s Insight Card at http://www.insightcards.com/images/uploads/110223_UTB_TCS-v3_2%20clean.pdf.

¹⁶ These states are Arkansas, Arizona, Colorado, Georgia, Montana, Ohio, Oregon, and Pennsylvania.

¹⁷ Form 8-K filed by Meta Financial Group, Inc. with the Securities and Exchange Commission, October 6, 2010, available at http://www.sec.gov/Archives/edgar/data/907471/000110465910052100/a10-19319_18k.htm. The 8-K reports: “The OTS advised us on October 6 that it has determined that the Bank engaged in unfair or deceptive acts or practices in violation of Section 5 of the Federal Trade Commission Act and the OTS Advertising Regulation in connection with the Bank’s operation of the iAdvance program, and required the Bank to discontinue all iAdvance® line of credit origination activity by October 13, 2010.”

¹⁸ The payday loans are hidden in the terms and conditions for Urban Trust Bank’s Insight Card, http://www.insightcards.com/images/uploads/110223_UTB_TCS-v3_2%20clean.pdf. They are available through the Bridge Account on the Insight Silver Prepaid Card offered by CheckSmart, an Arizona chain of

offered by Think Finance that was virtually identical to the iAdvance product. That product was withdrawn from the market shortly after the OTS shut down iAdvance, but Think Finance is reportedly looking for another issuer.¹⁹

It appears to be only a matter of time before payday loans spread further. We have been told that some in the banking industry view the proposed OCC guidance as legalizing the iAdvance product. Moreover, the CEO of the payday loan company that distributed the cards carrying the iAdvance product, when asked recently about banks' appetite for involvement in payday loans, responded that he viewed the guidance "very positively" and that "once . . . it was issued, we began [the] process of talking to additional financial institutions about the ability to get involved and assist them in a micro line of credit product whether it be laid over a card or DDA account."²⁰

C. Payday Loans by Banks Are, Indeed, Payday Loans.

Banks making payday loans claim their product is different from a loan from a payday storefront, but it is not. By calling their payday loan product a "direct deposit advance" or "checking account advance," banks attempt to differentiate it from other payday loans.²¹ The OCC has tried to distinguish the product as well; a spokesperson stated: "It's not a payday loan. It's available through banks and bank branches. It's something you don't get at a storefront . . . [and] customers . . . don't have to use it."²²

But these distinctions are superficial at best and fiction at worst. Payday loans by banks have all the hallmark characteristic of those made by payday shops:

payday loan-check cashers. Consumers are charged (and borrow) a \$3.50 load fee per \$25 borrowed in addition to an APR of 35.9%. The fees are taken up-front from the credit extended. So if a borrower wants \$100, she would take a loan of \$114, the \$14 load fee would be immediately repaid from the loan, and the \$114 loan, plus the interest that has accrued, would be repaid automatically upon the next direct deposit. Another variation of the Insight Card payday loan appears to operate like an overdraft loan, though with different pricing. The prepaid card carries a "negative balance" fee of \$0.15 for every \$1 in negative balance for overdrawing the card, up to \$36 in fees. That fee is equal to \$15 per \$100 borrowed—typical payday loan pricing—or 391% if repaid in two weeks.

¹⁹ Sara Lepro, *Banks, Regulators Dubious about Debit-Credit Products*, American Banker (Dec. 6, 2010).

²⁰ Daniel Feehan, President, Chief Executive Officer and Director of Cash America, speaking on the company's second quarter 2010 investor call, July 20, 2011.

²¹ See, e.g., Chris Serres, "Biggest banks stepping in to payday arena: The big guns' entry into payday lending may finally bring fringe financial product out of the shadows and into the financial mainstream, despite howls of protest from consumer groups and the risk of tighter regulation," *Star-Tribune*, Sept. 6, 2009 and Lee Davidson, "Do banks overcharge?," *Deseret Morning News*, Jan. 22, 2007 (citing statements by spokespersons from one bank offering payday loans about how its products differ from payday loans because customers cannot rollover loans and cooling off periods exist).

²² Katherine Reynolds Lewis, *Watchdog Group Raises Alarm Over 'Payday Loans' at Mainstream Banks*, Washington Independent, April 5, 2010 (quoting OCC spokesperson Dean DeBuck).

Comparison of Loan Features: Bank Payday Loan vs. Non-bank Payday Loan		
	Bank Payday Loan	Non-bank Payday Loan
Cost of typical loan	365% APR ²³	417% APR ²⁴
Repayment timing and amount	Due in full upon the customer's next deposit	Due in full at customer's next payday
Access to checking account funds for repayment	Bank repays itself automatically from the customer's next deposit, whether it is a paycheck or public benefits, like unemployment or Social Security	Lender has customer's post-dated check or electronic access to the customer's checking account
Underwriting borrower's ability to repay loan without funds provided by an additional payday loan	None	None

As described below, CRL research also shows that bank payday lending has many of the same problems as non-bank payday loans, including high costs and a long-term debt trap.

D. Payday Loans, Whether by Storefronts or by Banks, Result in Long-Term Indebtedness and Extraordinarily High Accumulated Fees.

Payday loans are fundamentally structured in a way that makes them likely to lead to repeat loans by those shouldering most of the cost: high cost; short-term balloon repayment; the bank's repaying itself before all other debts or expenses, directly from the customer's next deposit; and lack of appropriate underwriting that assesses the customer's ability to repay the loan without taking out another loan shortly thereafter.

²³ Calculated based on the cost banks typically charge for payday loans—\$10 per \$100—and the typical loan term CRL's analysis found, ten days. One bank charges \$7.50 per \$100 borrowed.

²⁴ Calculated based on a typical cost of \$16 per \$100 borrowed (Stephens Industry Report, Payday Loan Industry, June 6, 2011. at 23, Figure 14) and a common pay cycle, two weeks.

Non-bank payday borrowers routinely find themselves unable to repay the loan in full and the fee *plus* meet their monthly expenses without taking out another payday loan. Recent CRL research found that the typical non-bank payday borrower takes out nine loans per year; that borrowers take out loans for more and more over time as they are driven deeper into debt; and that nearly half of borrowers (44 percent)—after years of cyclic debt—ultimately default.²⁵ Previous CRL research has found that the typical borrower will pay back \$793 in principal, fees, and interest for the original \$325 borrowed.²⁶ Calling these loans “short-term,” then, is a misnomer; they engender long-term indebtedness at a very high cost.

Research has also found that “protections” like installment options and breaks between loans, or “cooling off periods,” which have been legislated in some states, have been ineffective at stopping the cycle of debt for non-bank payday borrowers.²⁷ Indeed, the payday industry, which has repeatedly acknowledged that it relies on loan flipping, or a cycle of long-term, repeat use, to remain profitable,²⁸ has been willing to endorse these

²⁵ CRL’s recent analysis of Oklahoma data showed that payday borrowers were loaned greater amounts over time (i.e., an initial loan of \$300 loan increased to \$466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half of borrowers (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011) [hereinafter *Payday Loans, Inc.*], available at <http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf>. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

²⁶ Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with \$4.2 billion in predatory fees every year* at 6, Center for Responsible Lending (Nov. 30, 2006), available at <http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial-Quicksand-1106.pdf>.

²⁷ See Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are only proven payday lending reform*, Center for Responsible Lending (Dec. 13, 2007) [hereinafter *Springing the Debt Trap*], available at <http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf>.

²⁸ Payday lending industry representatives have noted on numerous occasions that repeat borrowers are extremely important to them. Several examples are cited in *Springing the Debt Trap* at 11-12: “A note about rollovers. We are convinced the business just doesn’t work without them” (Roth Capital Partners, First Cash Financial Services, Inc., Company Update, July 16, 2007); “We saw most of our customers every month—a majority came in every month” (Rebecca Flippo, former payday lending store manager, Henrico County, VA); “This industry could not survive if the goal was for the customer to be ‘one and done.’ Their survival is based on the ability to create the need to return, and the only way to do that is to take the choice of leaving away. That is what I did” (Stephen Winslow, former payday lending store manager, Harrisonburg, VA). Industry researchers and analysts have noted the same: “The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers” (Michael Stegman and Robert Faris, “Payday Lending: A Business Model that Encourages Chronic Borrowing,” *Economic Development Quarterly*, Vol. 17, No. 1 (February 2003); “We find that high-frequency borrowers account for a disproportionate share of a payday loan store’s loan and profits... the business relies heavily on maximizing the number of loans made from each store” (Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research (June 2005), available at http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf).

“protections”²⁹—because, while they “increase[] recognition and legitimacy of this product,” as one payday lender noted,³⁰ they do not break that cycle of debt. Here, we provide more information on each of these two failed policy options:

- *Installment options.* Lenders have little incentive to encourage borrowers to use installment options and often make them available only to borrowers who have already been in debt to the lender for a period of time and/or in exchange for a considerable upfront fee, among other eligibility restrictions.³¹ Research has found that in Florida, Michigan, Oklahoma, and Washington state, less than two percent of transactions in each state employed the installment option.³² Data from Washington state further show that enactment of an installment option in 2005 had virtually no impact on the cycle of repeat use: Annual loans per borrower decreased from 9 to 8.5, and the percentage of loans made to borrowers with five or more loans per year decreased from 91 percent to 90 percent.³³
- *Breaks between loans.* Many state policymakers have enacted renewal bans to address concerns that ostensibly short-term payday loans are repeatedly rolled over into long-term debt. In fact, almost every state allowing payday lending has some sort of restriction on the renewal of payday loans.³⁴ Florida and Oklahoma both have cooling off periods; in Florida, despite this “protection,” 96 percent of repeat loans are taken out within the same billing cycle; in Oklahoma, that figure is 94 percent.³⁵

As discussed further in Section II.I.2.e, while banks’ cooling off periods are typically longer than those in the states, these still do not, and cannot, address the fundamental abuses of the product—and indeed have the effect of “legitimizing” the abuses, as the payday lender above recognized. The bank payday product still traps customers in debt, and the cooling off period comes only after the account holder has incurred huge fees. Moreover, the banks’ cooling off periods are even more porous a “protection” than storefront payday lenders’, given the availability of bank overdraft programs as another short term, high-cost debt product. When federal regulators told banks they could not engage in payday partnerships, they did

²⁹ See “Best Practices for the Payday Advance Industry,” Community Financial Services Association, available at www.cfsa.net/industry_best_practices.html.

³⁰ *Springing the Debt Trap* at 12 (citing Veritec Solutions LLC, *The Florida Deferred Presentment Program Myths & Facts* (September 2002)).

³¹ *Springing the Debt Trap* at 14.

³² *Id.* at 14, Table 8.

³³ *Id.* at 15.

³⁴ *Id.* at 13.

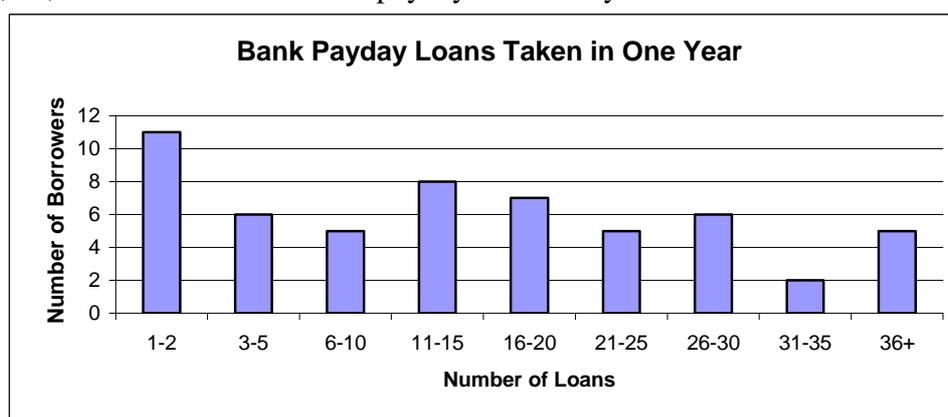
³⁵ *Id.*

not carve out expansive loopholes that allowed them to continue that engagement; the OCC should not do so now.

CRL recently began investigating payday loans by banks to determine how their use compares with patterns of use for non-bank payday loans.³⁶ For the analysis, we used a database composed of real bank customers’ actual checking account activity. We found that:

- Bank payday loans are very expensive, typically carrying an annual percentage rate (APR) of 365 percent based on the typical loan term of ten days;³⁷ and
- Short-term bank payday loans often lead to a cycle of long-term indebtedness; on average, bank payday borrowers are in debt for 175 days per year.³⁸

CRL’s analysis of 55 consumers with bank payday loans showed that many borrowers took out ten, 20, or even 30 or more bank payday loans in a year:



³⁶ For a complete discussion of this research, see Center for Responsible Lending, “Big Bank Payday Loans,” CRL Research Brief, July 2011 [hereinafter “Big Bank Payday Loans”], available at <http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf>. For the analysis, CRL used checking account data from a nationwide sample of U.S. credit card holders, generally representative across geography, household income, and credit scores, tracked by Lightspeed Research Inc. Participating account holders provide Lightspeed access to all of their checking account activity occurring during their period of participation, including the deposits, paper checks, electronic bill payments, debit card purchases, fees, and miscellaneous charges or credits that are posted to the account. The analysis included transaction-level data for 614 checking accounts, over a 12-month period; this was the total number of checking accounts in the consumer panel held at banks that were found to offer payday loans, based on observing instances of payday loans in the accounts. We identified instances of bank payday loan repayments within 55 of those 614 accounts, and analyzed these for loan term, loan frequency, repayments, and other relevant factors.

³⁷ This APR is based on a fee of \$10 per \$100 borrowed, which most banks making payday loans charge. One bank charges \$7.50 per \$100 borrowed.

³⁸ “Big Bank Payday Loans” at 5. The analysis found that, on average, bank payday borrowers have 16 loans and, assuming these loans were not concurrent, stay in payday debt for 175 days per year. The average loan duration for all panelists was 10.7 days.

The table below illustrates the reason for these repeat loans. A borrower earning \$35,000 a year would be hard-pressed to pay back a \$200 bank payday loan and a \$20 fee as a balloon repayment in just one pay period. The bank would, of course, repay itself, but the borrower will be left with insufficient funds to make it to the end of the next pay period without having to take out another payday loan:

Cost of a Two-week, \$200 Bank Payday Loan

<i>Income and Taxes</i>	
Income per two-week pay period	\$1,342.47
Federal, state and local taxes	(\$11.16)
Social Security tax (at 4.2% rate)	(\$56.38)
Income after tax	\$1,274.93
Payday loan payment due on \$200 loan ³⁹	(\$220.00)
Paycheck remaining after paying back payday loan	\$1,054.93
<i>Household Expenditures per two-week pay period</i>	
Food	\$181.69
Housing	\$498.09
Utilities	\$126.15
Transportation	\$242.07
Healthcare	\$102.95
Total essential expenditures	\$1,150.95
Money from paycheck remaining (deficit)	(\$96.02)

Source: 2009 Consumer Expenditure Survey, households earning \$30,000-\$39,999. This example is of a borrower earning \$35,000 per year and excludes other costs such as childcare and clothing.

The bank's direct access to the customer's checking account exacerbates this debt trap, jeopardizing income needed for necessities and undercutting laws protecting Social Security, disability income, unemployment compensation, and other exempt funds.⁴⁰ Borrowers have no choice about the amount or timing of the repayment; they lack the ability to prioritize rent or their children's shoes or their parents' medicine above repayment of this debt to the bank.

³⁹ Based on banks' typical cost of \$10 per \$100.

⁴⁰ A significant number of payday borrowers are public benefits recipients, and CRL's recent research found that nearly one-quarter of all bank payday loan borrowers are Social Security recipients. (See Section E for further discussion.) It is likely that many bank payday borrowers also receive public benefits through unemployment compensation, disability income, Temporary Assistance to Needy Families, and other sources. That proportion will only increase with new rules eliminating paper checks for federal benefits payments and requiring direct deposit or use of a prepaid card.

An insider at one national bank offering payday loans has admitted, “Many [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken.”⁴¹

E. Payday Loans, Made by Storefronts or by Banks, Cause Serious Financial Harm.

Research has shown that payday lending often leads to negative financial outcomes for borrowers; these include difficulty paying other bills, difficulty staying in their home or apartment, trouble obtaining health care, increased risk of credit card default, loss of checking accounts, and bankruptcy.⁴²

More vulnerable consumers are more likely to be harmed by payday loans. Payday loan shops have been shown to target people of color when locating their stores.⁴³ In addition, CRL’s recent research report on bank payday lending found that nearly one-quarter of all bank payday borrowers are Social Security recipients, who are 2.6 times as likely to have used a bank payday loan as bank customers as a whole.⁴⁴ On average, the bank seized 33 percent of the recipient’s next Social Security check to repay the loan.⁴⁵

⁴¹ David Lazarus, *120% rate for Wells’ Advances*, San Francisco Chronicle, Oct. 6, 2004.

⁴² See the following studies for discussions of these negative consequences of payday lending: Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008), available at www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221; Sumit Agarwal, Paige Skiba, and Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* Federal Reserve of Chicago, Vanderbilt University, and the University of Pennsylvania (January 13, 2009), available at <http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf>; Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School (June 6, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873; Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, University of Chicago Business School (November 15, 2007), available at http://insight.kellogg.northwestern.edu/index.php/Kellogg/article/the_real_costs_of_credit_access; and Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, “An Experimental Analysis of the Demand for Payday Loans” (April 1, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796.

⁴³ In California, payday lenders are 2.4 times more concentrated in communities of color, even after controlling for income and a variety of other factors. State surveys have found that African Americans comprise a far larger percentage of the payday borrower population than they do the population as a whole. Wei Li, Leslie Parrish, Keith Ernst and Delvin Davis, *Predatory Profiling The Role of Race and Ethnicity in the Location of Payday Lenders in California*, Center for Responsible Lending (March 26, 2009), available at <http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf>.

⁴⁴ “Big Bank Payday Loans” at 7. With respect to proportion of all borrowers who are Social Security recipients, the 95 percent confidence interval is 14 percent to 36 percent. The difference in likelihood to take a bank payday loan for Social Security recipients was statistically significant at the p<5 percent level.

⁴⁵ *Id.* The 95 percent confidence interval is 26 percent to 40 percent.

Loans from payday shops have been found to increase the odds that households will repeatedly overdraft and eventually lose their checking accounts.⁴⁶ There is no reason to believe that payday lending by banks would not have the same effect. Bank payday loans enable banks to collect additional fees from consumers who are already struggling with overdrawn accounts, as evidenced by the case study of the Social Security recipient below, who, over two months, paid \$162 in payday loan fees plus \$57 in overdraft fees.

Moreover, if funds are not directly deposited into a borrower's account from which the bank payday loan can be repaid within 35 days, the institution pays itself back automatically by pulling funds from the borrower's bank account. If this withdrawal overdraws the customer's account, all subsequent withdrawals posted to the account (like checks, automatic bill payments, or debit card transactions) may incur an overdraft or non-sufficient-funds fee until the next deposit is made.

The following real-life examples illustrate the harm caused by bank payday loans:

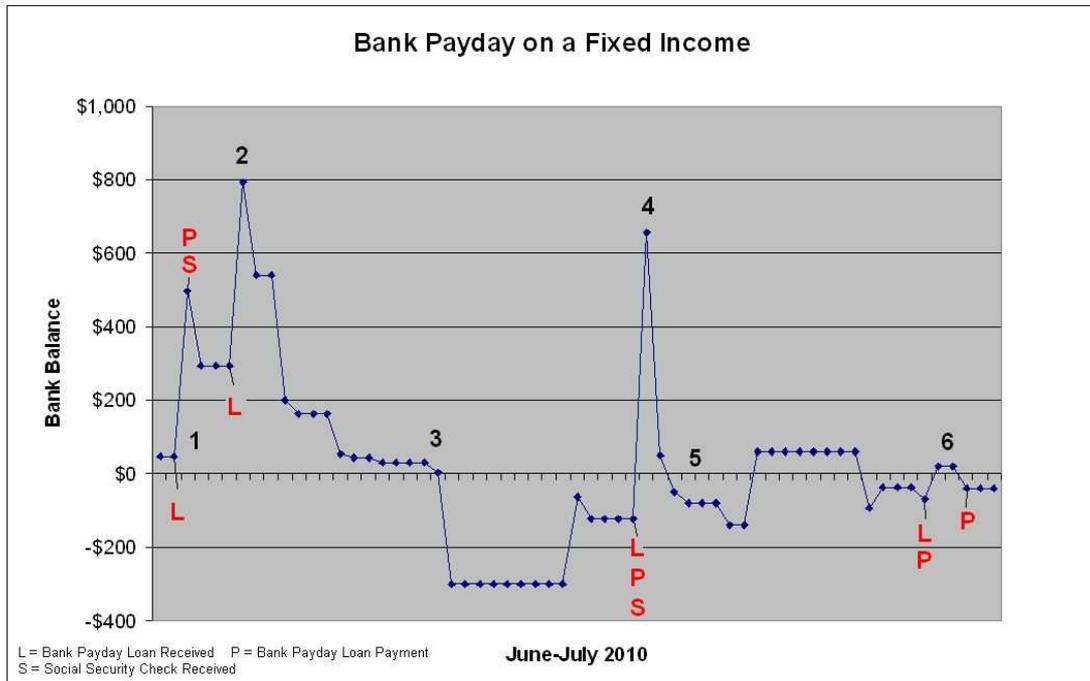
a. **Mr. A (as reported in CRL's recent report, *Big Bank Payday Loans*⁴⁷):**

The following graph maps two months of checking account activity of Mr. A, a bank customer in CRL's database whose primary source of income is Social Security. The line on the graph represents the borrower's account balance. It goes up when the customer receives a direct deposit, other deposit, or a payday loan or overdraft loan. It goes down when checks, bill payments, debit card transactions, or other withdrawals are posted to the account, or when the bank collects the payday loans (after a direct deposit is received) or overdraft loans (when any deposit is received) and the associated fees.

This graph demonstrates that payday loans and overdraft loans only briefly increase the customer's account balance. A few days later, when the principal and fees are collected in one lump sum, the customer's account balance decreases dramatically, which causes the borrower to take out another high-cost loan. At the end of the two-month period—having been in payday debt, overdraft debt, or both, for 57 out of 61 days and having paid \$219 in fees to borrow less than \$650—the borrower is again left with a negative balance, in an immediate crisis, in need of another loan.

⁴⁶ In North Carolina, payday borrowers paid over \$2 million in NSF fees to payday lenders in addition to the fees assessed by their banks in the last year their practice was legal. 2000 Annual Report of the North Carolina Commissioner of Banks." Moreover, a Harvard study found an increase in the number of payday lending locations in a particular county is associated with an 11 percent increase of involuntary bank account closures, even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. Dennis Campbell, Asis Martinez Jerez, and Peter Tufano (Harvard Business School). *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*. June 6, 2008, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873. See also "Payday Loans Put Families in the Red."

⁴⁷ "Big Bank Payday Loans" at 10.



- 1: Bank payday loan takes balance up to \$500.
- 2: Borrower receives June Social Security Check, and bank uses deposit to pay off first bank payday loan. Panelist then takes out second bank payday loan, reaching his highest balance for the two-month period.
- 3: Several large bills and payments put our panelist on the verge of overdraft, and the payback for the payday loan is about to come due!
- 4: July's Social Security Check and a new bank payday loan bring our panelist out of an overdraft, which costs him \$57 in fees.
- 5: More bills and the payday loan payback take him right back into overdraft.
- 6: Small bills and payday loan fees and paybacks offset small deposits, transfers, and bank payday loans, and our panelist begins August in the red.

b. Mr. B (as reported in NCLC's Report, *Runaway Bandwagon*⁴⁸):

Mr. B, a Social Security recipient using Wells Fargo's payday loan program, found himself paying exorbitant interest rates and locked in a cycle of debt that aggravated rather than alleviated financial distress. A review of 39 consecutive monthly statements showed that Mr. B had taken out 24 payday loans of \$500, averaging approximately eight days each, with the shortest running just two days and the longest 21 days. The finance charges for these short-term loans totaled \$1,200, and their effective APRs ranged from 182 percent to 1,825 percent. Ironically, even though bank payday loans are marketed as a way of avoiding overdraft fees, Mr. B still ended up paying \$676 in overdraft penalties on top of the \$1,200 in loan fees.

⁴⁸ Leah Plunkett and Margot Saunders, *Runaway Bandwagon: How the Government's Push for Direct Deposit of Social Security Exposes Seniors to Predatory Bank Loans* at 21, National Consumer Law Center (July 2010), available at <http://www.nclc.org/images/pdf/pr-reports/runaway-bandwagon.pdf>. Actual account activity of Mr. B is also available at Appendices A-C of that report.

c. **Mr. C (as described by a legal services attorney⁴⁹):**

“More than a year ago, Mr. C obtained a \$500 advance on his Social Security check. Since that time, each month Wells Fargo withdraws the \$500 from his account as well as a \$50 fee. Since Mr. C has no other money, he then has to get a new advance each month. This ‘payday’ type loan continues, except Wells Fargo has told Mr. C that they now have a maximum number of times per year that this can be done, and he can only do this for another two months. Mr. C has attempted to obtain loan from W[ells] F[argo] so that he can pay money back over longer period. W[ells] F[argo] told him that his credit is poor and that he needs someone to co-sign the loan. Mr. C has no one to do this. Mr. C [is] considering bankruptcy.”

F. Payday Loans by Banks Circumvent State Laws Prohibiting High-Cost Loans.

In most states in which payday lenders operate, they are allowed to charge triple-digit rates because of special exemptions from the state’s traditional interest rate caps, which apply to consumer finance loans and other small-loan products. Payday loans are banned or significantly restricted in 18 states and the District of Columbia, as several states have re-instituted interest rate caps in recent years, and others never allowed these loans to be part of their small loan marketplace.⁵⁰ Other states limit fees or require longer loan terms that restrict payday loans.

Despite these restrictions, at least two national banks are currently offering triple-digit, short-term balloon-payment payday loans in at least eight of the 18 states with interest rate or other significant limits on payday loans.⁵¹ Banks argue that they can ignore state laws under national bank preemption standards, which permit national banks to override state law in some circumstances.

Bank payday loans also undermine restrictions on nonbank payday lenders. Payday lenders sell prepaid cards, issued by banks, with a payday loan feature. Cash America was selling NetSpend prepaid cards issued by MetaBank with access to the iAdvance payday loan before the OTS shut them down. After Arizona’s payday loan authorization law

⁴⁹ This story was described by a legal services attorney to the National Consumer Law Center; email on file with NCLC.

⁵⁰ High-cost single-payment payday loans are not authorized by law in the following states/jurisdictions: Arkansas, Arizona, Colorado, Connecticut, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Jersey, New Hampshire, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. Although interest rate caps vary by state, most are about 36 percent APR. In a few instances, payday lenders attempt to circumvent state protections by structuring their loans to operate under other loan laws not intended for very short-term, single payment loans.

⁵¹ These states are Arkansas, Arizona, Colorado, Georgia, Montana, Ohio, Oregon, and Pennsylvania.

expired, reinstating the usury cap, CheckSmart (an Ohio payday lender with stores in Arizona) started selling prepaid cards issued by Urban Trust Bank with a payday loan feature.

G. Payday Loans by Banks Undermine Federal Law Aimed at Protecting Military Service Members.

In 2006, Congress passed a law to protect active-duty members of the military and their families from predatory lending. The “Talent/Nelson Military Lending Act” (Talent-Nelson) banned loans that were secured by borrowers’ checks, other methods of access to the account, or the title to vehicles; and capped interest rates, including fees and insurance premiums, at 36 percent for loans defined as “covered credit” by the Department of Defense. The protection grew from concern by the Department of Defense and base commanders that troops were incurring high levels of high-cost payday loan debt that was threatening security clearances and military readiness.⁵² The President of Navy-Marine Corps Relief Society testified before Congress that “[t]his problem with... payday lending is the most serious single financial problem that we have encountered in [one] hundred years.”⁵³

The 36 percent rate cap applies to bank as well as nonbank payday loans. But banks structure their loans in a way that attempts to evade the definition of “covered credit” under the Military Lending Act. The definition of “covered credit” applies to “closed-end” credit loans (that is, having a fixed date of repayment).⁵⁴ Banks call their payday loans “open-end” instead, even though the loan is indeed ultimately due 35 days later (if the customer’s deposits made sooner than 35 days later are not sufficient to repay the loan).

Both large national banks making payday loans are operating on military bases. We confirmed with representatives of those banks last week that these loans are available to service members.⁵⁵

⁵² See *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, Department of Defense (August 9, 2006), available at www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf.

⁵³ Testimony of Admiral Charles Abbot, US (Ret.), President of Navy-Marine Corps Relief Society, Before U.S. Senate Banking Committee, September 2006.

⁵⁴ 32 CFR 232.3(b).

⁵⁵ Wells Fargo operates on the following bases: Fort Benning (GA), Fort Gordon (GA), Joint Base McGuire-Dix-Lakehurst (NJ), Holloman AFB (NM), Kirtland AFB (NM), Minot AFB (ND), Fort Jackson (SC), Shaw AFB (SC), Fort Bliss (TX), and Hill AFB (UT) and U.S. Bank operates at Malmstrom AFB (Montana). Association of Military Banks of America, *Bank Institutions Located on Military Installations*, November 2010. Regions, a Fed-member bank, operates at Red Stone Arsenal (AL) and Scott Air Force Base (IL). *Id.* Fifth-Third, also FRB-supervised, does not have branches on bases, but it does advertise “Military Banking” on its website; this page does not mention its payday loan product, but it also does not indicate that the product is not available to service members. See <https://www.53.com>; under “Checking Accounts” tab, “Military Banking Benefits” is a selection.

H. Payday Loans by Banks Run Counter to Trends in Public Sentiment and the Law.

Public sentiment and state law are moving decisively against payday loan shops. In three recent ballot initiatives in Montana, Arizona and Ohio, voters resoundingly rejected payday lending, despite payday industry campaigns costing tens of millions of dollars.⁵⁶ In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for a 36 percent annual rate limit on payday loans, rather than the 400 percent which they typically charge.⁵⁷

In addition, since 2007, seven states and the District of Columbia have enacted or enforced meaningful reform to address payday lending⁵⁸—while no state without payday lending has authorized it since 2005.

Federal law, too, has moved against payday lending. As noted earlier, in 2006, Congress enacted Talent-Nelson, which limited loans made to active-duty military personnel and their families to 36 percent annual percentage rate. In 2005, the FDIC imposed the guidelines described above limiting the length of time banks should allow borrowers to be in payday loan debt.⁵⁹ And in 2010, the National Credit Union Administration (NCUA) opted to permit short-term, small-dollar loans at a slightly higher cost (no more than 28

⁵⁶ In Montana in 2010, 72 percent of voters said yes to lowering rates from 400 percent to 36 percent APR on all small dollar loans. In Arizona in 2008, voters in every county in the state rejected 400 percent rates in favor of restoring the state's existing 36 percent APR on unsecured loans. In Ohio, in 2008, 70 percent of voters said yes to affirm the legislatively enacted 28 percent rate cap for payday loans.

⁵⁷ In Iowa, Virginia and Kentucky, where recent statewide polls have been conducted to measure support for a limit to the amount of interest payday lenders can charge, both Republican and Democratic voters have responded overwhelmingly: 69-73 percent of voters in each of these states favor a 36 percent APR cap. See Ronnie Ellis, *Payday Lenders Targeted for Interest Rates*, The Richmond Register (Feb. 8, 2011), available at <http://richmondregister.com/localnews/x2072624839/Payday-lenders-targeted-for-interest-rates>. See also *Poll Reveals strong bi-partisan support for payday lending reform*, Iowapolitics.com (Jan. 26, 2011), available at <http://www.iowapolitics.com/index.ihtml?Article=224730>; Janelle Lilley, *Virginia Payday Lending Bill Dies in Senate, Survives in House*, WHSV.com (Jan.18, 2011), available at [http://www.wHSV.com/home/headlines/Virginia Payday Lending Bill Dies in Senate Survives in House 114169549.html](http://www.wHSV.com/home/headlines/Virginia%20Payday%20Lending%20Bill%20Dies%20in%20Senate%20Survives%20in%20House%20114169549.html).

⁵⁸ The seven states are Arkansas, Arizona, Colorado, New Hampshire, Ohio, Oregon, and Montana.

⁵⁹ FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, available at <http://www.fdic.gov/news/news/financial/2005/fil1405a.html>.

percent APR) only three times in a six-month period.⁶⁰ And recently, Treasury prohibited payday loan features on prepaid cards onto to which federal benefits are deposited.⁶¹

I. The OCC’s Proposed Guidance Would Undermine Its Principles and Risks Legitimizing Current Practices.

The OCC’s concerns about payday lending, as noted in its guidance, include:

- failure to monitor accounts for excessive costs and usage;
- failure to evaluate “appropriately” the customer’s ability to repay;
- requiring full repayment out of a single deposit, “which reduces funds available to customers for daily living expenses, which can cause overdrafts”;
- steering customers who rely on direct deposits of public benefits payments as their principal source of income into this product.⁶²

We share these concerns; indeed, they are at the heart of our key recommendations. To address these concerns, the OCC lays out principles that include prudent limitations on cost and usage and ability to repay and manage credit,⁶³ which we wholly support.

At the same time, the OCC intends its guidance to provide a “high degree of flexibility” for banks and expects banks as well as examiners to use “sound judgment and common sense” in applying these principles to applicable products. Importantly, several aspects of the proposed application of the principles could actually legitimize core problems that the OCC identifies by suggesting that with minor changes, abusive practices can continue. The most immediate and analogous precedent for this guidance is the 2005 Joint Best Practices for overdraft programs,⁶⁴ which, as discussed in Section III.A below, effected virtually no change in the marketplace but the flourishing of abuses. We are deeply concerned that without incorporating our recommendations below, months and years from now, this proposed guidance will have had much the same result.

⁶⁰ Even these more expensive loans are limited to 28 percent APR. NCUA, Short-Term, Small Amount Loans, Final Rule, Sept. 2010, *available at* <http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf>.

⁶¹ 31 CFR 212.1, effective as of May 1, 2011.

⁶² OCC Proposed Guidance, 76 Fed. Reg. 33412.

⁶³ *Id.* at 33410. The principles also include disclosure of costs, terms, and alternative products; compliance with the law, including the prohibition against unfair and deceptive practices; affirmative request of the product; not promoting routine use; eligibility criteria; attention to reputation risks and undue reliance on revenue from a particular product; monitoring excessive use; and monitoring third-party vendors, all of which we support.

⁶⁴ Department of the Treasury-Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127 (Feb. 24, 2005) [hereinafter 2005 Joint Guidance on Overdraft Programs].

1. Key recommendations addressing payday lending by banks.

Our primary recommendations addressing bank payday lending are as follows:

- ***The OCC should take immediate supervisory and/or enforcement action to stop banks from making unaffordable, high-cost payday loans.***

The OCC has clear authority to stop its banks from engaging in payday lending; it did so a decade ago when it stopped “rent-a-bank” partnerships that evaded state laws. Since then, through regulations and a series of interpretive letters, the OCC has expanded the scope of federal preemption, leaving states little control over the loans that national banks make to their own residents.⁶⁵ The OCC’s role in preventing states from addressing the product themselves should only further compel it to address the issue directly.

The OTS recently shut down MetaBank’s iAdvance payday program, citing unfair and deceptive practices (UDAP). We expect that the OTS’s UDAP concerns related to product features shared by the very similar payday loans being made by OCC-supervised banks. The OCC should take similarly strong action immediately, even prior to finalization of its proposed guidance. Banks should not be in the business of making payday loans.

- ***In the alternative, the OCC should impose an immediate moratorium on the bank payday product (stopping it at the banks offering it and prohibiting it at additional banks) while collecting data to evaluate the appropriateness of the product.***

The host of concerns the OCC has expressed about this product in its proposal provide justification for stronger action than the application of principles the OCC has illustrated. CRL’s recent research regarding the long-term, high-cost indebtedness the product causes provides further justification for stronger action. If the OCC does not prohibit the product immediately, it should impose a moratorium on the product at the banks currently offering it while it collects data and evaluates the appropriateness of the product in light of the OCC’s own principles. Data collected should include the following:

- the bank’s costs related to making payday loans;
- average number of loans, and the range, per borrower per year;
- average number of days, and the range of days, between a borrower’s loans;
- average loan term and the range;
- average loan amount and the range;
- number and dollar amount of loans repaid and fees paid by public benefits recipients, including by the type of benefits received;

⁶⁵ National Consumer Law Center, *Cost of Credit: Regulation, Preemption and Industry Abuses*, Sec. 3.4 (4th Ed. 2009).

- average monthly wage, and income range, of payday borrowers;
- number and percent of borrowers whose direct deposit income is not sufficient to repay the loan, and of those,
 - number and percent whose accounts enter overdraft status when the bank repays itself;
 - amount of subsequent overdraft fees those borrowers pay
- amount payday borrowers pay in overdraft fees overall;
- number and percent of borrowers whose accounts are closed or frozen due to unpaid payday loans;
- number and percent of borrowers placed in the bank payment plan, and their experience once in the plan;
- demographic characteristics of borrowers, with an eye toward fair lending concerns;
- other small dollar loan products, including overdraft options, offered by the bank and the demographics of those borrowers.

With respect to this guidance as written, in order for it to address the concerns the OCC has expressed:

➤ *The OCC should require that loans:*

- a. be repaid in affordable installments, as installment options and cooling off periods will not curb repeat use;*
- b. be reasonably priced, where cost of credit is expressed as an interest rate and any fees are reasonable;*
- c. be underwritten based on an ability to repay without needing to take out another loan shortly thereafter;*
- d. not be repaid through automatic setoff against the customer's deposits (and especially when those are exempt funds), consistent with the prohibition on wage garnishments in the Credit Practices Rule.*

2. Discussion of proposed guidance addressing payday loans.

a. Affordable installments.

To further its principle that customers have the ability to manage and repay credit, the OCC recommends, among other provisions addressed later, that advances should be “permitted” to be repaid in installments over a period of longer than one month (“when program terms allow for substantial advances, relative to the regular deposit amount”).⁶⁶ As noted above in our discussion of the debt treadmill, balloon repayments deal a devastating blow to customers with limited means. Unfortunately, “permitting” installment plans will not stop balloon repayment loans from remaining the norm.

One national bank already permits installment repayment plans, but only after a customer has been in payday debt for three consecutive statement periods and owes \$300 or more on the loan, not including the fees. And the customer must call the bank to enter a payment plan, whereas typical, balloon-repayment draws can be done via the internet. One state-chartered bank offering payday loans “permits” repayment plans but only for an additional fee of \$50, which must be paid at the time the loan is made. In both of these cases, despite “permitting” a repayment plan, the default loan structure into which customers are steered is the balloon repayment due in full upon the customer’s next direct deposit.

As explained earlier, the same is true at payday loan shops. The payday lending industry is quick to endorse repayment plans as a “protection” for borrowers, but borrower use of installment plans is extremely rare—in the one-to-two-percent range.⁶⁷ As with banks, payday storefronts often make them available only to borrowers who have already been in debt to the lender for a considerable period of time and/or in exchange for a considerable upfront fee, among other eligibility restrictions.⁶⁸ Even if there were no eligibility restrictions, lenders have little incentive to encourage these plans.

Thus, installment options are a gimmick; worse yet, where they carry fees or eligibility requirements, they are a hoax.

Recommendation: *It is absolutely essential that the OCC require that loans be structured to be repaid in affordable installments.*

⁶⁶ OCC Proposed Guidance, 76 Fed. Reg. at 33413.

⁶⁷ *Springing the Debt Trap* at 14, Table 8.

⁶⁸ See *Springing the Debt Trap*. In the vast majority of states that ban renewals or refinancing of existing payday loans, the borrower, lacking the funds to both repay the loan and meet other obligations, simply repays one loan and immediately takes out another. This is often called a “back-to-back” transaction, and the effect it has on the borrower’s finances is identical to a renewal. Take-up rates for installment plans typically hover in the 1 to 2 percent range.

The FDIC’s small-loan guidelines recommend a term of at least 90 days;⁶⁹ another approach could be to offer a guideline that at least one month should be permitted for every \$100 outstanding.⁷⁰ Requiring installment payments alone would result in a more reasonable number of loans made each year and would prevent a large final payment that necessitates repeat loans.

b. Reasonable cost.

We agree with the OCC’s principle advising prudent limitations on cost. However, the OCC’s only reference to cost in its discussion of payday lending is its suggestion that banks disclose that payday loans “can be costly.” This effectively condones current pricing and will not send the message that the cost should be dramatically reduced.

Moreover, to disclose that the product “can be costly” is not accurate. CRL’s research finds that payday loans by banks average 365 percent APR. Even if the loan were outstanding for the entire billing cycle (the average term is actually 10 days), the cost would be 120 percent APR. The product *is* costly, and this cost is a critical component of what leads to repeat use.

Recommendation: *The OCC should require that the cost of credit be expressed primarily as an annual interest rate and endorse the APR guideline of 36 percent adopted in the FDIC’s small dollar loan guidelines. As explained below, if the OCC does not require reasonably priced products, banks will more easily evade even strong provisions prohibiting balloon repayments; in that case, the OCC should include a strong provision prohibiting subterfuge efforts.*

Interest-based pricing ensures that cost is proportional to the amount of credit and time over which it is extended. Fee-based pricing typically leads to misleading and very high costs. Annual interest rate disclosures are also critical to a customer’s ability to compare the cost of credit products.⁷¹ Banks should not be able to skirt them, or emphasize a flat fee while hiding the APR in the fine print, by calling a loan product with a maximum 35-day term “open-end” credit.

There are also fair lending concerns to using interest-based pricing for one group of consumers and fee-based pricing, a characteristic of predatory lending, for others.

⁶⁹ FDIC Affordable Small Loan Guidelines.

⁷⁰ See National Consumer Law Center, “Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don’t.” at 15 (June 2010), available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

⁷¹ See Center for Responsible Lending, “APR Matters on Payday Loans: Interest rate disclosures allow apple-to-apple comparisons, protect free market competition,” June 2009, available at <http://www.responsiblelending.org/payday-lending/research-analysis/apr-matters.pdf>.

Further, although the OCC may not be in a position to set an interest rate cap, it can use its guidance to encourage banks to offer credit at affordable rates. Any fees should be reasonable and reflect the cost to the institution of making the loan. The FRB’s definition of “application fee” should be a guideline for the type of fees that are appropriate.⁷²

Finally, addressing the cost of the product is essential because addressing the balloon repayment—while also essential—without addressing cost will not prevent banks from offering extremely high-cost installment loans that effectively function just like a series of payday loans flipped multiple times. This subterfuge effort is growing more common in states without usury caps where payday lenders attempt to evade payday loan laws by structuring their product as an installment loan.⁷³ The OCC should at a minimum make clear that it will use enforcement action to stop subterfuge efforts aimed at evading anti-balloon repayment provisions.

c. Ability to repay without taking out additional loans.

The OCC notes concern about “[f]ailure to evaluate the customer’s ability to repay the credit line appropriately, taking into account the customer’s recurring deposits and other relevant information.”⁷⁴ We strongly support an ability-to-repay principle. However, we are concerned that the OCC has not framed its ability-to-repay principle in a meaningful way, that certain passages in the guidance could undermine the ability-to-repay principle, and that its specific recommendations regarding ability to repay do not compensate for the irresponsible *structure* of the loan.

⁷² 12 C.F.R Part 226, Supp. I, Section 226.4—Finance Charge, 4(c) Charges excluded from the finance charge. Paragraph 4(c)(1). Note that one OCC-supervised institution, Guaranty Bank, appears to charge solely an “application fee” for its payday loan product and no other fee, interest rate or other finance charge. It is questionable whether the fee meets the Regulation Z definition of “application fee” or the disclosures are in compliance with TILA. Unless the bank has no credit losses, cost of funds, customer service expenses, or other ongoing costs, the application fee is covering far more than the expenses permitted under Regulation Z and therefore is not a bona fide application fee.

⁷³ In 2005, Illinois enacted the Payday Loan Reform Act, providing a number of restrictions on payday loans, but it did not cap rates for small loans. Payday lenders began making 120 day or longer “installment” loans that were structured as payday loans “flipped” multiple times (instead of typical two-week loan). Advocates observed rates in excess of 1000 percent APR. Tom Feltner, Woodstock Institute, *Beyond Payday Loans: The Segmentation of the Consumer Installment Loans in Illinois*, Presentation to Consumer Federation of America, December 3, 2008.

In 2007, New Mexico enacted several changes to its Small Loan Act, including establishing a database and banning rollovers, but still allowing 400 percent APR on payday loans. Lenders began making 35-day or longer “installment” loans that fall outside of the 2007 law. Advocates observed rates in excess of 1000 percent APR. Nathalie Martin, “1,000% Interest—Good While Supplies Last: A Study Of Payday Loan Practices And Solutions,” 52 *Arizona Law Review* 563 (2010), available at <http://www.arizonalawreview.org/pdf/52-3/52arizrev563.pdf>

⁷⁴ OCC Proposed Guidance, 76 Fed. Reg. at 33412.

i. Appropriate framing of “ability to repay.”

The OCC does not address a central concern about ability-to-repay in the context of small dollar loans: that *meaningful* ability-to-repay means that the customer has the ability to repay the loan *without taking out another loan shortly thereafter*. As discussed above, the very structure of this product (high cost, short-term balloon repayment) makes many customers’ ability to do that unlikely.

Further, the OCC advises banks to assess the customer’s ability to repay based on information about the customer’s “continued employment or other recurrent source(s) of income from which the direct deposit is derived and other relevant information,”⁷⁵ without explaining what other information would be relevant. We do not suggest that banks should require a detailed and documented loan application for every small dollar loan. However, banks that hold customers’ deposits already possess detailed information about a consumer’s transaction history, which includes their expenses and average balance, and they should evaluate these metrics to determine the likelihood that a consumer has residual income available to repay a loan, without taking out another loan shortly thereafter.

Moreover, the OCC’s proposed guidance would undermine its ability-to-repay principle by providing the following example of when credit should no longer be extended: “when a customer’s direct deposits stop.”⁷⁶ Both national banks making payday loans already require that customers have direct deposits in order to qualify for credit; this example establishes a low bar for determining ability to repay and condones the status quo.

We are also concerned by the OCC’s reference to “other recurrent source(s) of income” without further discussion about the inappropriateness of seizing exempt benefits to repay debt. We discuss this concern further in subsection d regarding setoff.

ii. Limits that will not ensure meaningful ability to repay.

(a) Limits on repayment amount.

The proposed guidance tells banks to recognize “the need for a portion of deposited funds to remain available to the customer for daily expenses”⁷⁷ and advises that banks establish a limit on the amount or percentage of any deposit that may be used for repayment. We support the aim of this recommendation, but we are concerned it will not result in meaningful changes.

⁷⁵ *Id.*

⁷⁶ OCC Proposed Guidance, 76 Fed. Reg. at 33413.

⁷⁷ *Id.* at 33412.

CRL’s research finds that banks take an average of 44 percent of the borrower’s next deposit to repay a bank payday loan.⁷⁸ This is not a surprising figure, since banks will lend up to the lesser of \$500 or one-half of the borrower’s monthly direct deposit income.

It seems that banks could “comply” with the OCC’s proposal by acknowledging they take 44 percent of the customer’s next deposit, leaving 56 percent available to the customer for “daily expenses.” But research has shown that leaving 56 percent available is not sufficient; it results in an average of 16 loans and 275 days of indebtedness each year.

(b) Limits on repayments that overdraw the account.

The OCC further advises that banks should not permit repayments that would overdraw the account.⁷⁹ While we support the aim of this provision, we are concerned that the OCC appears to condone repayments that take the account so close to zero that they lead to overdrafts even within the same day. The OCC advises banks to disclose that repayment “may” take priority over other payments and “could” result in overdrafts.⁸⁰ Therefore, while the OCC notes the repayment of the loan itself should not overdraw the account, it would continue to permit overdraft fees to be charged on any subsequent payments, even those made the same day, and even if the overdrafts would not have occurred *but for* the repayment of the payday loan. This result is inconsistent with the recommendation that funds should remain available for the customer’s daily expenses and inconsistent with the spirit of this recommendation that repayment not overdraw the account.

(c) Limits on loan amount.

The OCC advises banks to limit the “amount or percentage of any deposit that may be advanced” (emphasis added).⁸¹ We agree that small-dollar loan amounts should be limited. However, we are concerned that the OCC’s guidance does not suggest concerns with the status quo and that certain language would undermine this recommendation. Moreover, even lower levels of debt will not typically be manageable if they are due in full upon the customer’s next deposit.

The OCC’s own description of the product states that advances already are “typically . . . limited to the amount, or a portion of the amount, of the anticipated deposit.”⁸² Currently, banks limit the percentage of a customer’s monthly direct deposit income that may be

⁷⁸ “Big Bank Payday Loans” at 6.

⁷⁹ OCC Proposed Guidance, 76 Fed. Reg. at 33413.

⁸⁰ *Id.* at 33412.

⁸¹ *Id.* at 33413.

⁸² *Id.* at 33412.

advanced (to one-half or \$500, whichever is less), and as a result, for customers who are paid twice monthly, the advance may equal 100 percent of the upcoming deposit.⁸³

But the proposed guidance suggests that high limits—perhaps even current limits—are acceptable, noting “when program terms allow for substantial advances, relative to the regular deposit amount,” installment payments should be permitted.⁸⁴

Moreover, the emphasis solely on incoming funds that can be offset to pay the loan neglects to assess whether the consumer can afford to repay the loan without taking out another loan.

Recommendations:

The OCC should—

- *address the fundamental loan structure (require affordable installment payments and reasonable cost) to make it dramatically more likely that customers will be able to repay the loan;*
 - *frame its ability-to-repay recommendation in terms of the customer’s ability to repay the loan without taking out another loan shortly thereafter; this should include an evaluation of more than income alone;*
 - *make clear that banks should presume that customers do not have the ability to repay a “substantial” advance relative to their regular deposit amount in a short-term, balloon repayment without having to take out another loan shortly thereafter;*
- d. No automatic setoff against a customer’s deposits, and particularly from exempt benefits.

In Part IV, we discuss in more detail the legal issues involved with banks’ practice of repaying themselves directly from customers’ deposits. These include federal and state protections of wages and exempt benefits from garnishment, as well as a provision in the Electronic Fund Transfer Act (EFTA) that prohibits conditioning credit on automatic repayment.

The OCC’s proposed guidance advises that deposit advances “should be permitted to be repaid by direct deposit or by separate payment in advance of the date a deposit would be debited without any additional fee.”⁸⁵ We agree that consumers should not be charged a

⁸³ See Appendix A.

⁸⁴ OCC Proposed Guidance, 76 Fed. Reg. at 33413.

⁸⁵ *Id.*

fee for electing a payment method other than automatic electronic payment. However, as described below, we are concerned that the proposed guidance does not address charging *refundable* fees, as one bank currently does, or require that banks allow customers to repay by other methods even if the payment is not received in advance. As a result, the OCC’s guidance would facilitate, rather than address, evasions of laws meant to protect customers’ deposits from seizure.

Currently, one national bank offers a “payment by mail” option that carries a \$100 refundable fee, refunded after the customer has repaid two loans using this method.⁸⁶ This option still requires the customer to repay the loan in full 25 days after the last statement date, regardless of when the loan was made. This is not a meaningful option, as making the fee “refundable” makes no immediate difference for a cash-strapped consumer. This is merely a nominal “option,” likely designed to allow the bank to assert that it is not *conditioning* credit on automatic repayment.⁸⁷

The proposed guidance also indicates that consumers should be able to make a repayment “in advance of the date a deposit would be debited . . .” It suggests that the originally scheduled debit should indeed go through if repayment is not received in advance, again seeming to condone conditioning credit on automatic repayment. A consumer who elects a different method of payment should be able to use that method exclusively and not be required to make payments ahead of the due date. Moreover, the “in advance” language could be read to condone the typically extremely short repayment terms, suggesting that customers must repay even sooner to avoid automatic debit of their accounts.

Customers receiving public benefits are at risk of heightened harm from automatic setoff, but we are concerned that the OCC’s guidance also condones seizing public benefits to repay payday loan debt. The OCC notes concern about “[s]teering customers who rely on direct deposits of federal benefits payments as their principal source of income to deposit advance products.”⁸⁸ We agree with this concern (not only regarding federal benefits, but also state disability, unemployment, or other exempt benefits), but the problem is not steering alone; it is the structure of the product, including automatic account seizure. Moreover, the OCC’s advisement that banks evaluate a customer’s ability to repay by reviewing “employment or other recurrent source(s) of income,”⁸⁹ with no discussion of concern for public benefits, appears to inadvertently condone automatic repayment from these funds. *See* Section IV.B. for further discussion.

⁸⁶ *See* Appendix A.

⁸⁷ The Federal Reserve Board’s commentary on Regulation E permits an institution to offer a reduced annual percentage rate or other cost-related incentive if the consumer agrees to preauthorized electronic fund transfers, as long as the creditor also gives the consumer the option of other types of payment programs. Official Staff Interpretations of Reg. E, 12 C.F.R. Pt. 205, Supp. I, § 205.10(e)-1).

⁸⁸ OCC Proposed Guidance, 76 Fed. Reg. at 33412.

⁸⁹ *Id.*

Recommendations:

The OCC should:

- *advise banks that they are expected to comply with the letter and the spirit of the EFTA ban on mandatory electronic repayment for all types of loans (see Section IV.D. for further discussion);*
- *indicate that no additional fee may be required for other payment methods, whether or not it is refundable;*
- *direct banks to the FRB’s Regulation E commentary, making clear that consumers only truly have the option of other types of payment methods if a discount for electronic payment is modest, not so large as to effectively preclude other options.*

e. Cooling off periods will not stop the cycle of debt.

To support its principle of prudent limitations on usage, the OCC recommends that banks require “cooling off” periods after a certain number of back-to-back loans and a limit on the number of months advances can be outstanding. Cooling off periods are not substitutes for structural reform, will not achieve limited usage, and in fact legitimize the basic abusive structure by condoning repeat loans for some period of time. Indeed, they are a recognition that the products are used repetitively as several-months-long loans and not as loans designed to be affordable and repayable in a single pay cycle.

The OCC’s 2000 payday lending guidance highlighted concerns about multiple renewals, noting that “renewals without a reduction in the principal balance . . . are an indication that a loan has been made without a reasonable expectation of repayment at maturity.”⁹⁰ Frequent, nearly back-to-back transactions are the functional equivalent of multiple renewals, and cooling off periods legitimize them.

Banks making payday loans already have cooling off policies in place. These policies are entirely ineffective in addressing the debt-trap issue of payday lending: They allow those banks’ customers to remain in payday debt for eleven months of the year and accumulate hundreds of dollars of fees before the cooling off period begins:

⁹⁰ OCC Advisory Letter on Payday Lending.

Long-term indebtedness permitted with cooling off periods:

Bank	Days indebtedness permitted prior to end of cooling off period	Back-to-back fees permitted prior to end of cooling off period (c)	Approx. maximum number of days indebted annually	Approx. maximum share of year indebted
National Bank 1 (a)	300 days	\$600	330 days	92 percent of the year
National Bank 2 (b)	270 days	\$900	330 days	92 percent of the year

(a) National Bank 1’s customers can borrow for six straight months up to the maximum credit limit before the credit limit is reduced by \$100 for each subsequent month of use. Once the credit line is at zero for one month (which would be month 11), the entire cycle can begin again in month 12. This chart assumes that the borrower reaches the *maximum* credit limit each of the first six months in debt; if not, the cooling off period would not be triggered and the customer could stay in debt all 12 months of the year.

(b) National Bank 2’s customers incur a three-month cooling off period after taking out a loan in nine consecutive months. But the customer could borrow for eight months, take one month off, and borrow the remaining three months.

(c) This column assumes the customer remains in debt for consecutive months so that cooling off period is triggered as early as possible (beginning after 6 months for Bank 1; after 9 months for Bank 2) and that the customer takes out one loan every two weeks. Bank 1 charges \$7.50 per \$100 borrowed; Bank 2 charges \$10 per 100 borrowed.

As discussed earlier, cooling off periods applicable to payday storefronts at the state level have also been shown to be ineffective at stopping the cycle of debt, as the large majority of loans are still taken out within a few days of having repaid the previous one.⁹¹

Moreover, cooling off periods themselves pose dangers. Depending on how they are structured, a cooling off period can require consumers to go “cold turkey,” leaving them high and dry with a huge income gap during the cooling off month. The income gap during the cooling off period is a sign that the loan itself was unaffordable and predatory.

Similarly, the proposed guidance recommends that banks limit the number of months consumers are in debt. But it does not acknowledge that banks already do this, and that those limits are too high. With current limits—and cooling off periods—customers are in high-cost debt an average of 175 days per year and can be in this debt for 330 days per year.

⁹¹ *Springing the Debt Trap* at 13.

Recommendation: *To ensure limits on usage, rather than recommend cooling off or otherwise condone back-to-back loans, the OCC must require that loans be repaid in affordable installments and carry reasonable cost.*

III. High-Cost Overdraft Programs.

A. Regulatory Inaction Allowed Overdraft Programs to Morph from an Ad-Hoc Courtesy into Routine, Extremely High-Cost Credit.

The most dramatic growth in expensive short-term lending by mainstream banks has been in high-fee overdraft loans, which today cost Americans billions of dollars a year.⁹² Overdrafts frequently are triggered by small debit card transactions, which could easily be declined at no cost when the account lacks sufficient funds.⁹³ Most institutions offer far lower cost alternatives, but too many institutions aggressively steer customers to their highest cost overdraft coverage.⁹⁴ (For CFA’s recent survey of overdraft programs at the ten largest OCC-supervised banks, *see* Appendix B.)

Automated high-cost overdraft programs were not always widespread. What began as an ad-hoc occasional courtesy that banks and credit unions provided to their customers grew to a \$10.3 billion “service” in 2004 and to a \$23.7 billion one in 2008.⁹⁵ This growth was spurred in the late 1990s and early 2000s by heavy marketing of automated overdraft programs by consultants promising dramatic fee increases to banks.⁹⁶ Some consultants

⁹² See Leslie Parrish, *Overdraft Explosion: Bank fees for overdrafts increase 35% in two years*, Center for Responsible Lending (Oct. 6, 2009) [hereinafter *Overdraft Explosion*], available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/crl-overdraft-explosion.pdf>.

⁹³ Eric Halperin, Lisa James, and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending, at 25 (Jan. 25, 2007) [hereinafter *Debit Card Danger*], available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf>.

⁹⁴ Center for Responsible Lending Research Brief, *Banks Collect Opt-Ins Through Misleading Marketing*, April 2011 [*Banks Collect Opt-Ins Through Misleading Marketing*], available at <http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/banks-misleading-marketing.html>; Center for Responsible Lending Research Brief, “Banks Target, Mislead Consumers As Overdraft Deadline Nears,” Aug. 5, 2010, available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/Banks-Target-And-Mislead-Consumers-As-Overdraft-Dateline-Nears.pdf>.

⁹⁵ *Overdraft Explosion* at 5.

⁹⁶ See, e.g., Impact Financial Services’ website, <https://impactfinancial.com/portal/AboutIFS/FromPresidentsDesk/tabid/66/Default.aspx> (visited July 7, 2008 and Aug. 3, 2011) (“Virtually all of our clients have increased the NSF fee income from 50-150% or more”); Moeb’s Services, Inc.’s website, <http://www.moeb.com/Default.aspx?tabid=102> (visited July 9, 2008 and Aug. 3, 2011) (“overall fee income is increased by 200 percent”).

even offered the software at no risk, simply charging banks a percentage of the increased fee revenue generated.⁹⁷

This growth was also spurred by federal banking regulators, including the OCC, whose inaction, or lack of meaningful action, allowed overdraft abuses to persist and to grow. The OCC first recognized several overdraft practices as problematic as early as 2001, when a bank that the OCC supervised asked it for a “comfort letter,” or explicit approval, for the high-cost overdraft program it wanted to implement. Rather than providing this approval, the OCC articulated a number of compliance concerns about the program, noting “the complete lack of consumer safeguards,” including the lack of limits on the numbers of fees charged per month, the similarities between overdraft fees and other “high interest rate credit,” and the lack of efforts by banks to identify customers with excessive overdrafts and meet those customers’ needs in a more economical way.⁹⁸

Despite its articulation of these concerns, the OCC failed to act on overdraft practices until 2005, when it issued guidance jointly with other regulators.⁹⁹ Rather than explicitly prohibit or even effectively discourage the troubling practices it had identified in 2001, the OCC issued recommendations that financial institutions engage in “best practices.” These included limiting overdraft coverage to checks alone (i.e., excluding debit card and other transaction types); establishing daily limits on fees; monitoring excessive usage; and obtaining affirmative consent to overdraft coverage.¹⁰⁰

The guidance also cautioned banks against potential violations under the Equal Credit Opportunity Act (ECOA). OCC noted that “steering or targeting consumers . . . for [higher cost] overdraft protection programs while offering other consumers overdraft lines

⁹⁷ See, e.g., Impact Financial Services’ website, <https://impactfinancial.com/portal/WhatisIOP/HowTheProgramWorks/tabid/65/Default.aspx> (visited July 7, 2008 and Aug. 3, 2011) (“Since we don’t charge up-front or implementation costs and our fee is a percentage of the increased NSF income you earn from the service, you have no financial risk!”). For an early discussion about the growing problem of overdraft fees, see Consumer Federation of America and National Consumer Law Center, “Bounce Protection: How Banks Turn Rubber into Gold by Enticing Consumers To Write Bad Checks,” filed as Appendix to Comments to the Federal Reserve Board’s Proposed Revisions to Official Staff Commentary to Regulation Z Truth in Lending regarding Open End Credit and HOEPA Triggers and Solicitation for Comments on Bounce Protection Products, Docket No. R-1136, January 27, 2003, available at <http://consumerfed.org/elements/www.consumerfed.org/file/bounceappendix012803.pdf>.

⁹⁸ OCC Interpretive Letter # 914 (August 3, 2001), available at www.occ.treas.gov/interp/sep01/int914.pdf. The OCC raised compliance issues with respect to the Truth in Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, ECOA, and Regulation O (extensions of credit to bank insiders).

⁹⁹ OCC, Federal Reserve Board, FDIC, and National Credit Union Administration, Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127 (Feb. 24, 2005) [hereinafter Joint Guidance on Overdraft Programs].

¹⁰⁰ *Id.* at 9132

of credit or other more favorable credit products . . . will raise concerns under the ECOA.”¹⁰¹ These concerns remain true today.

With the exception of an isolated enforcement action against a small bank five years later,¹⁰² there has been no evidence that the OCC has enforced this guidance. The agency’s Consumer Compliance Handbook used by its examiners in their evaluation of banks makes no mention of these best practices; in fact, it doesn’t mention overdraft programs at all.¹⁰³

The guidance was widely ignored. Banks almost never sought affirmative consent to overdraft coverage (and rarely even made any right to opt out known to consumers), before required by Regulation E changes, and large national banks seemed to completely ignore the guidance, adopting none of the best practices listed above. Instead, overdraft abuses continued to flourish.

In November 2009, the Federal Reserve Board took the first regulatory action that promised to have any downward impact at all on overdraft lending, requiring that institutions obtain customers’ “opt-in” before charging overdraft fees on debit card purchases and ATM transactions.¹⁰⁴ This rulemaking helped spread awareness about these fees. But the rule merely established a baseline protection for debit card and ATM overdraft loans that virtually every other credit product already enjoys: consent. Consent requirements for credit cards and mortgages have never removed the need for substantive protections in those areas.

The Board’s rule failed to address the fundamental substantive problems with the overdraft product, including the manipulation of processing order to increase costs, a common practice among large banks;¹⁰⁵ the size and frequency of overdraft fees on debit cards, or on any type of transaction; and aggressive marketing and steering of high-volume overdrafters into high-cost programs.

Recognizing the need for further action on overdraft abuses, the FDIC finalized guidance in November 2010 urging banks to curb excessive overdraft fees—identifying more than

¹⁰¹ *Id.* at 9131

¹⁰² OCC Consent Order in the Matter of Woodforest National Bank, The Woodlands, TX, AA-EC-10-93, #2010-202, October 6, 2010, <http://www.occ.treas.gov/news-issuances/news-releases/2010/nr-occ-2010-122a.pdf>. OCC took action after the OTS cited the federal thrift section of that bank for egregious overdraft practices at WalMart stores.

¹⁰³ See <http://www.occ.treas.gov/handbook/compliance.htm>.

¹⁰⁴ 12 CFR 205.17(b).

¹⁰⁵ A recent report by Pew found that all of the ten largest banks paid transactions highest to lowest or reserved the “right” to through their disclosures. The Pew Health Group, *Hidden Risks: The Case for Safe and Transparent Checking Accounts*, April 2011. See also Appendix B.

six fees in a 12-month period as “excessive”—and telling banks to stop posting transactions in order from highest to lowest.

The Board’s overdraft opt-in rule did trigger a shift in the marketplace. The largest issuer of debit cards, Bank of America, stopped charging debit card point-of-sale overdraft fees altogether, joining Citi, which never has. HSBC has now stopped charging overdraft fees on debit card point-of-sale and ATM transactions. Overall, overdraft fees have decreased; one early study shows that bank service fee revenue decreased by \$1.6 billion in the six months following implementation of the opt-in rule.¹⁰⁶ Moreover, the study found that account balances increased during this time, despite the decrease in service charges (which, the study notes, generally change proportionally to account balances), demonstrating that the reduction in fees was due not to lower account balances, but to practices that were better for banks’ customers.¹⁰⁷

But too many banks, large and small, aggressively marketed overdraft “opt-in,” targeting the customers who generate the most fees and steering them to the highest-cost credit the bank offers.¹⁰⁸ The result has been that bank customers (who, as noted earlier, paid \$23.7 billion in overdraft fees in 2008) are still losing far too much of their incomes or public benefits to abusive overdraft fees.

Moreover, banks that have taken the high road thus far are left vulnerable to pressure from investors to backslide as they attempt to compete with banks that haven’t. And community banks covered by the FDIC’s guidance also must play by different rules than the large national banks and thrifts supervised by the OCC.

B. Overdraft Programs Cause Serious Financial Harm and Drive Customers Out of the Banking System.

Like payday loans, high-cost overdraft loans are structured in a way likely to lead to repeat loans by those shouldering most of the cost: short-term balloon repayment; high cost; lack of appropriate underwriting that assesses the customer’s ability to repay the loan without taking out another loan shortly thereafter; and the bank’s repaying itself before all other debts or expenses, directly from the customer’s next deposit.

¹⁰⁶ Market Rates Insight, *Reg E Lowered Account Service Fees by \$1.6 Billion Since Enactment*, June 21, 2011, available at <http://www.marketratesinsight.com/Blog/post/2011/06/21/Reg-E-lowered-account-service-fees-by-2416-billion-since-enactment.aspx>.

¹⁰⁷ *Id.* The study showed that in the third quarter of 2010, right after the opt-in rule went into effect, balances of transaction accounts increased by 0.7 percent, yet service fees decreased by 11.8 percent. In the fourth quarter, transaction account balances increased by 9.0 percent while service fees decreased by 7.2 percent. In the first quarter of 2011, balances increased by 3.7 percent while service fees remained unchanged.

¹⁰⁸ Center for Responsible Lending Research Brief, “Banks Collect Opt-Ins Through Misleading Marketing,” April 2011, available at <http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/banks-misleading-marketing.html>.

Customers struggling financially are unlikely to be able to both repay the loans and the associated high fees in one lump sum *and* continue to meet ongoing expenses; as a result, they must borrow again before the end of the pay cycle. Over time, the fees strip away at their cash assets, leaving them only financially worse off than when the lending began.

The FDIC’s recent overdraft guidance acknowledged that repeat overdraft fees can result in “[s]erious financial harm” for “customers with a low or fixed income.”¹⁰⁹ Some customers pay at least as much as \$1,600 annually in overdraft fees;¹¹⁰ the large majority of fees are paid by those who are overdrawn repeatedly and who are least able to recover from them.¹¹¹

The FDIC study also found that consumers living in lower-income areas bear the brunt of these fees.¹¹² Seniors, young adults, military families, and the unemployed are also hit particularly hard.¹¹³ Older Americans aged 55 and over paid \$6.2 billion in overdraft fees in 2008¹¹⁴—\$2.5 billion for debit card/ATM transactions alone¹¹⁵—and those heavily

¹⁰⁹ FDIC Supervisory Guidance for Overdraft Protection Programs and Consumer Protection, FIL-81-2010 (Nov. 24, 2010) [hereinafter FDIC 2010 Guidance on Overdraft Programs].

¹¹⁰ FDIC Study of Bank Overdraft Programs (Nov. 2008) at iv. Note that this study included only FDIC-supervised banks, whose average overdraft fees at the time were \$27 (*Id.* at v), compared to the average \$34 fee that consumers overall paid at that time (*Debit Card Danger* at 8). This \$34 average is influenced heavily by the fees charged at the largest banks, whose fees have averaged \$34-\$35 for several years. As a result, the FDIC’s study may understate the amount that many bank customers pay annually in overdraft fees.

¹¹¹ Research from the FDIC, consistent with CRL’s research, has found that account holders who overdraw their accounts five or more times per year paid 93 percent of all overdraft fees. FDIC Study of Bank Overdraft Programs at iv. Two CRL surveys, conducted in 2006 and 2008, found that 71 percent of overdraft fees were shouldered by only 16 percent of respondents who overdrawed, and those account-holders were more likely to be lower income, non-white, single, and renters when compared to the general population. Respondents reporting the most overdraft incidents were those earning below \$50,000. Leslie Parrish, “Consumers Want Informed Choice on Overdraft Fees and Banking Options,” CRL Research Brief (Apr. 16, 2008), available at <http://www.responsiblelending.org/pdfs/final-caravan-survey-4-16-08.pdf>.

¹¹² *Id.* at v.

¹¹³ For further discussion, see Comments of the Center for Responsible Lending to Board of Governors of the Federal Reserve System on Proposed Rule to Amend Regulation E—Overdraft Practices (Mar. 30, 2009), Part II.B.1(b), pp.10-12, available at http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/comments-regulation-e_overdraft-practices.pdf.

¹¹⁴ Leslie Parrish and Peter Smith, *Shredded Security: Overdraft practices drain fees from older Americans*, Center for Responsible Lending (June 18, 2008), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/shredded-security.pdf>. The figures in this report have been updated in the text above to reflect the increase in total overdraft fees paid by all Americans from \$17.5 billion in 2006 to \$23.7 billion in 2008. *Overdraft Explosion*.

¹¹⁵ *Shredded Security*. The report found that debit card POS and ATM transactions account for 37.4 percent and 2.5 percent, respectively (p.7), which, when calculated as a percentage of \$6.2 billion, together equal \$2.5 billion.

dependent on Social Security paid \$1.4 billion.¹¹⁶ Multiple surveys also have found that communities of color bear a disproportionate share of high-cost overdraft loans.¹¹⁷

Overdraft fees are the leading cause of involuntary bank account closures, driving many vulnerable consumers from the banking system, leading to greater numbers of unbanked households.¹¹⁸ Former FDIC Chair Sheila Bair has noted that “[r]epeat use of fee-based overdraft protection doesn’t make sense for anyone.”¹¹⁹

Real Life Example Demonstrating Harm:

In CRL’s report on the impact of overdraft fees on older Americans, we graphed two months of actual checking account activity of one panelist, whom we call Mary, from our database.¹²⁰ Mary is entirely dependent on Social Security for her income. We also graphed what her activity would have been with an overdraft line of credit. We later added a third scenario to the graph: no fee-based coverage at all, reflected below:

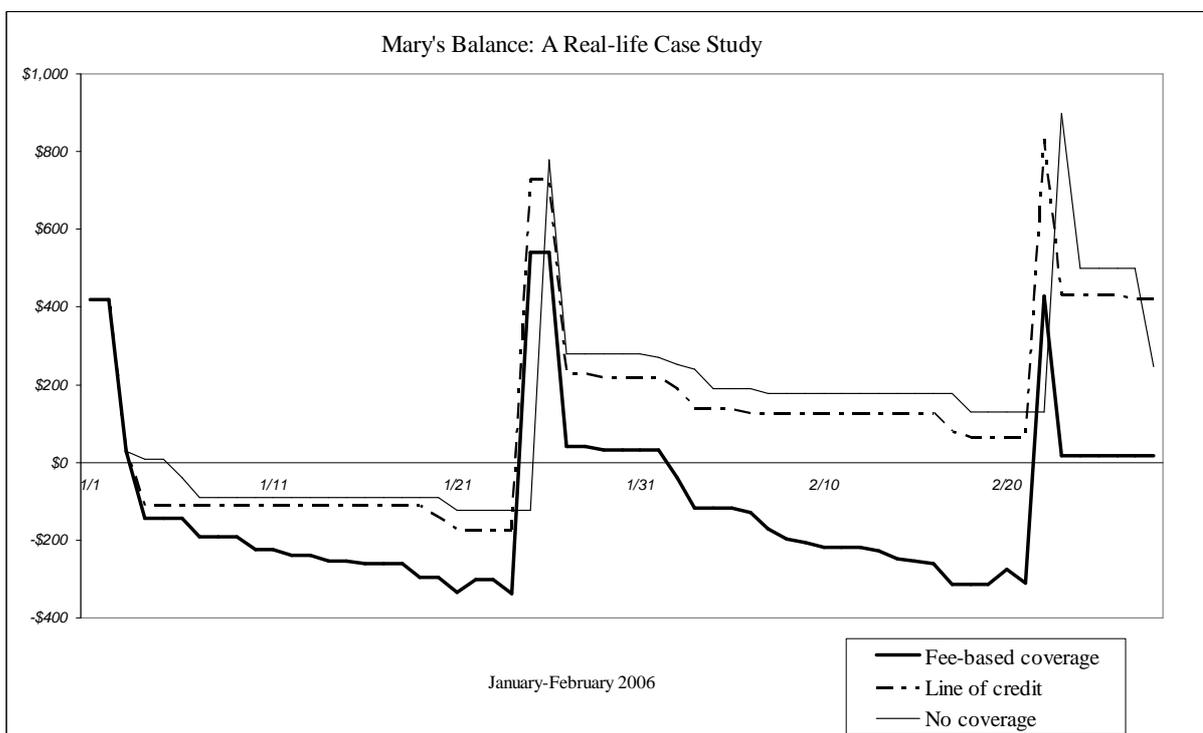
¹¹⁶ *Id.* at 6, Table 1. “Heavily dependent” was defined as recipients who depended on Social Security for at least 50 percent of their total income.

¹¹⁷ CFA’s 2004 survey found that 45 percent of African Americans had experienced overdrafts, compared with only 28 percent of consumers overall. In 2006 and 2008, CRL found that only 16 percent of people who overdraft pay 71 percent of all overdraft fees, and those individuals are more likely than the general population to be lower income and non-white. CFA conducted another survey in July 2009, finding that African Americans were twice as likely as consumers overall to have experienced overdrafts.

¹¹⁸ Overdraft fees are a significant reason that individuals who had bank accounts at one time are no longer banked. The FDIC’s National Survey of Unbanked and Underbanked Households, FDIC (December 2009) found that one-third of previously banked households no longer had an account because they felt the cost was too high, including minimum balance requirements, overdraft fees, and other service charges. A survey in the Detroit area found that among those surveyed who formerly had a bank account, 70 percent chose to close the account themselves, citing moving, worrying about bouncing checks, and excessive fees as their reasons for closing the account. The remaining formerly banked, 30 percent, reported that their bank closed their account; the primary reason was bounced checks and overdrafts. Michael S. Barr, University of Michigan Law School, *Financial Services, Savings and Borrowing Among Low- and Moderate-Income Households: Evidence from the Detroit Area Household Financial Services Survey* (March 30, 2008). See also Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School (June 6, 2008) (noting that virtually all involuntary bank account closures, when the financial institution closes a consumer’s account, occur because the customer overdrew the account an excessive number of times).

¹¹⁹ Sandra Block, “Banks changing how they handle overdrafts; New rule requires them to get permission from customers before they charge a fee,” *USA Today* (June 25, 2010).

¹²⁰ CRL analyzed 18 months of bank account transactions, from January 2005 to June 2006, from participants in Lightspeed Research’s Ultimate Consumer Panel. For further discussion of our database and methodology, see Eric Halperin & Peter Smith, *Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending at 13-14, (July 11, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf> [hereinafter *Out of Balance*].



During January and February of 2006, Mary overdrew her account several times and was charged \$448 in overdraft fees. At the end of February, she had \$18.48 in her account. She was trapped in a destructive cycle, using the bulk of her monthly income to repay costly overdraft fees.

With an overdraft line of credit at 18 percent over the same period, Mary would have paid about \$1 in total charges for her overdrafts instead of \$448 in overdraft fees. Even if Mary had had no overdraft coverage at all, she would have been better off than she was with fee-based overdraft. Five of her transactions, totaling \$242, would have been denied—two point-of-sale transactions and three electronic transactions. She would have been charged no fee for the two point-of-sale transactions. She may or may not have been charged an NSF fee for each of the three denied electronic transactions. She also may have been charged late fees if any of the electronic transactions were bills. Assuming, conservatively, that she was charged an NSF fee and a late fee for each of the three transactions, the chart illustrates that, after reflecting payment of the \$242 in denied transactions, her ending balance still would have been \$247—far higher than it was with fee-based overdraft coverage.

Mary's situation illustrates a problem common among the repeat overdrafters who pay the vast majority of the fees: Overdraft fees beget more overdraft fees. *Ultimately, fee-based overdraft coverage prevents account holders from being able to meet obligations they otherwise would have been able to meet—leaving them worse off than no overdraft coverage at all.*

C. The OCC’s Proposed Overdraft Guidance Would Undermine Its Principles and Would Not Significantly Curb Abusive Practices.

In the context of deposit-related credit products generally, the OCC notes that it has found that “a small percentage, but not an insignificant number” of banks are providing credit products without proper attention to risks, and that “[i]n some cases, these program weaknesses are strikingly apparent.”¹²¹ Although this may be true in the context of bank payday, where still relatively few banks are offering the product, in the overdraft context, abuses are far more widespread. The OCC cites the following concerns; we agree with all of them, and as supported by our discussion above and by the survey of overdraft practices at Appendix B, we believe that all of these abuses are common throughout the industry:

- payment processing “intended to” maximize overdrafts and related fees;
- “heightened” safety and soundness risks stemming from overdraft programs with their expansion to debit cards;
- imposition of fees that “cumulatively exceed a customer’s overdraft credit limit”;
- failure to monitor usage;
- failure to assess a customer’s ability to manage and repay credit;
- failure to monitor promotional practices for “potentially misleading statements”;
- and
- undue reliance on overdraft fee income.¹²²

Again, our recommendations aim to increase the likelihood that the OCC’s guidance will successfully address these concerns.

1. Key recommendations addressing high-cost overdraft programs.

The following are our key recommendations on overdraft, further discussion of which follows in subsection 2.

- ***The OCC must explicitly prohibit posting transactions in order from highest to lowest.*** The FDIC recently made clear that high-to-low posting is inappropriate; the OCC should do the same.
- ***In addition, the OCC should require that banks minimize fees through posting order when feasible.*** The OCC should establish a specific posting order that serves as a safe harbor and that explicitly provides, at a minimum, that credits be posted before debits; that checks, ACH, and recurring debit card transactions be posted in order from lowest to highest; and that no transactions be posted in order from highest to lowest.

¹²¹ OCC Proposed Guidance, 76 Fed. Reg. 33410.

¹²² *Id.* at 33411.

- ***The OCC should prohibit overdraft fees on debit card and ATM transactions***, which can easily be declined at no cost. Citibank has never charged such fees, and HSBC has stopped charging them. Bank of America, the largest debit card issuer, stopped overdraft fees at the point-of-sale last year. The OCC must level the playing field, or banks that have taken the higher road are susceptible to backsliding as they attempt to compete with banks that haven't. Ending overdraft fees on debit cards would go a long way toward ending excessive numbers of overdraft fees.
- ***The OCC should require that overdraft fees be reasonable and proportional to the amount of the underlying transaction and the cost to the bank***, consistent with the FDIC's overdraft guidance and rules governing penalty fees on credit cards. Permitting penalty fees to be an unrestrained profit center only encourages banks to push their customers into making mistakes.
- ***The OCC should limit overdraft fees to six per year***, consistent with the FDIC's recent recognition that more than six overdraft fees per year is excessive. ***After that point, overdraft is acting as an exorbitantly priced credit product that is not appropriate for anyone, and any overdrafts covered should be done so on traditional terms (i.e., line of credit or transfers from other accounts)***. The FDIC recently recognized that more than six fees per year is excessive; the OCC should do the same and require that any overdrafts that are covered after six fees are charged be covered on traditional terms (i.e., line of credit or transfers from other accounts). For any brief period during which payday lending by banks continues, this limit should apply to overdraft and payday loans combined.
- ***The OCC should monitor overdraft programs closely and rigorously collect data to facilitate its enforcement of the guidance.***
- ***Even prior to finalization of this guidance, the OCC should heighten enforcement of the 2005 Joint Guidance*** on overdraft programs. Despite its weaknesses, including regarding transaction posting order, that guidance does call on banks to monitor excessive use; to consider limiting overdraft programs to checks, i.e., excluding debit card and ATM transactions; and to ensure compliance with the Equal Credit Opportunity Act.

2. Discussion of proposed guidance addressing overdraft programs.

a. Posting order: no high-to-low; minimize fees when feasible.

With respect to limiting cost and usage, the OCC advises that transaction processing not be “solely designed or generally operated to maximize overdraft fee income” and provides the following examples of methods it deems acceptable: “in the order received, by check or

serial number sequence, or in random order.”¹²³ We are encouraged that the OCC has raised this issue and has not named “highest to lowest” among appropriate posting orders, but we are concerned that by not being more explicit about what is and is not appropriate, the OCC’s guidance would allow banks to continue to increase fees through posting order.

First, advising that posting order should not be “solely” designed to maximize fees leaves room for a bank to assert that it has other motives, such as “protecting” consumers who want their large rent or mortgage checks paid first. This argument is disingenuous in an age of automated overdraft programs because banks often cover all overdrafts regardless of the order in which they are posted, but the OCC has defended it, including currently on its consumer help website.¹²⁴ It is not difficult to imagine, then, that banks would continue to post high-to-low, assert this justification, and consider themselves in compliance with the guidance.

Further, elsewhere in the guidance, the OCC’s advised disclosure related to transaction posting risks could undermine ending high-to-low posting. The OCC recommends “[c]lear disclosure about the order of processing transactions *and the fact that the order can affect the total amount of overdraft fees incurred by the customer.*”¹²⁵ This is the disclosure many banks have used for years to protect themselves from backlash against manipulative, high-to-low posting orders. While not untrue in the context of chronological posting order (since lowest to highest would result in fewer fees), the recommended disclosure should be accompanied by clear instruction to stop posting transactions in order from highest to lowest.

Manipulation of transaction ordering has long been a concern for regulators.¹²⁶ The OCC and other regulators raised the issue in the 2005 Joint Guidance on Overdraft Programs but only recommended that banks inform customers that transaction ordering may increase

¹²³ *Id.*

¹²⁴ See OCC’s website, Help With My Bank, at <http://www.helpwithmybank.gov/get-answers/bank-accounts/overdraft-fees-and-protection/faq-banking-overdraft-08.html>, last visited August 5, 2011. “Q: My bank paid my largest check first and then the smaller ones. Doing so created more overdraft fees on my account. Why did the bank pay in this order? A: You may write your checks in numerical order, but that doesn't mean the bank will post them that way. The same is true with point-of-sale or other electronic transactions: They don't necessarily post in the order in which you made the purchases. When several items come to the bank for clearing, it can choose to debit them from your account in several ways. Many national banks are opting to post the largest dollar items first instead of posting the checks in numerical order. Often the largest check represents payment for rent, mortgage, car payments, or insurance premiums. If your bank adopts this policy throughout its territory, it normally will notify you via your statement.”

¹²⁵ OCC Proposed Guidance, 76 Fed. Reg. 33411.

¹²⁶ It has also long been a concern for consumers. In June 2005, CFA, Consumer Union, CRL, NCLC, and USPIRG wrote to the four federal banking regulators, and among other things urged them to bring FTC Act cases against banks that “order debit processing to maximize fee revenue while routinely covering overdrafts for their account holders,” June 8, 2005.

fees.¹²⁷ In its own 2005 guidance, the OTS went further, explicitly stating that, as a best practice, transaction-clearing processes should not be manipulated to inflate fees.¹²⁸ In its 2009 final Regulation E rule, the Federal Reserve identified transaction posting order as an area that may need additional consumer protections and indicated it would continue to assess it.¹²⁹

Last year, a federal court ordered Wells Fargo to reimburse its account holders in California over \$200 million in overdraft fees triggered by reordering transactions to maximize fees.¹³⁰ After a thorough review of the bank's internal communications, the court concluded that "the only motives behind the challenged practices were gouging and profiteering."¹³¹

The FDIC recently instructed banks that they should "avoid[] maximizing customer overdrafts and related fees through the clearing order."¹³² It further explained that transactions should be processed "in a neutral order that avoids manipulating or structuring processing order to maximize customer overdraft and related fees," adding "[r]eordering transactions to clear the highest item first is not considered neutral."¹³³

The OCC should state at least as explicitly that posting highest to lowest is inappropriate. Moreover, overdraft fees are so high, so punitive, that banks should be expected to *minimize* them when feasible. Earlier this year, Citibank began posting checks in order from lowest to highest, noting, "We think this is the right thing to do."¹³⁴ It has since announced plans to do the same with ACH transactions later this year. The OCC should level the playing field. An opaque, complicated practice like transaction posting is not one that banks are competing based on; instead, it should be standardized. Further, minimizing costs for consumers finds precedent in the Credit CARD Act's amendment to TILA, which

¹²⁷ Joint Guidance on Overdraft Programs, 70 Fed. Reg. at 9132.

¹²⁸ OTS Guidance on Overdraft Programs, 70 Fed. Reg. 8428, 8431 (2005).

¹²⁹ 74 Fed. Reg. 59050: "The Board recognizes that additional consumer protections may be appropriate with respect to overdraft services, for example, rules to address transaction posting order. Therefore, the Board is continuing to assess whether additional regulatory action relating to overdraft services is needed."

¹³⁰ *Gutierrez v. Wells Fargo Bank, N.A.*, IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, No. C 07-05923 (August 10, 2010), WL 3155934 (N.D.Cal.).

¹³¹ *Id.*

¹³² FDIC 2010 Guidance on Overdraft Programs.

¹³³ FDIC Overdraft Payment Program Supervisory Guidance, Frequently Asked Questions, *available at* <http://www.fdic.gov/news/conferences/overdraft/FAQ.pdf>.

¹³⁴ Ann Carrns, *Citi's New Policy May Mean Fewer Bounced Checks*, N.Y. Times, April 7, 2011 (citing company memo written by Cece Stewart, Citibank's president of consumer and commercial banking).

requires that any payments above the minimum payment be applied to the balance carrying the highest interest rate first.¹³⁵

Recommendations: *The OCC must—*

- *explicitly prohibit posting transactions in order from highest to lowest;*
- *require that banks minimize fees through posting order when feasible;*
- *determine, and direct banks to use, a specific posting order that serves as a safe harbor and that explicitly provides, at a minimum, that credits be posted before debits; that checks, ACH, and recurring debit card transactions be posted in order from lowest to highest; and that no transactions be posted in order from highest to lowest.*

b. Prohibit overdraft fees on debit card and ATM transactions.

The OCC explicitly notes its concern with “heightened” safety and soundness risks stemming from the expansion of overdraft programs to debit cards. We agree with this concern and believe that the most appropriate way to address it is for the OCC to prohibit the practice altogether. This action would also significantly address the agency’s recommendation of limits on usage.

The largest debit card issuer, Bank of America, stopped charging overdraft fees on point-of-sale transactions last year, and HSBC stopped charging these fees at the point-of-sale and the ATM. Citi has never charged these fees. Neither merchants nor banks charge fees for declined point-of-sale or ATM transactions,¹³⁶ and surveys have repeatedly found that customers would prefer to have their debit card declined than covered for a fee.¹³⁷ As

¹³⁵ Truth in Lending Act, Sec. 164(b): “Upon receipt of a payment from a cardholder, the card issuer shall apply amounts in excess of the minimum payment amount first to the card balance bearing the highest rate of interest, and then to each successive balance bearing the next highest rate of interest, until the payment is exhausted.”

¹³⁶ In its final Regulation E rule in November 2009, the Federal Reserve indicated that such a practice would raise unfairness concerns: “A few commenters suggested the possibility that financial institutions may create new fees for declining ATM or one-time debit card transactions. While the final rule does not address declined transaction fees, the Board notes that such fees could raise significant fairness issues under the FTC Act, because the institution bears little, if any, risk or cost to decline authorization of an ATM or one-time debit card transaction.” Federal Reserve Board, Final Rule, Electronic Funds Transfers, Regulation E, Docket No. R-1343, 74 Fed. Reg. 59041 (Nov. 17, 2009).

¹³⁷ See, e.g., Leslie Parrish, “Consumers Want Informed Choice on Overdraft Fees and Banking Options,” CRL Research Brief (Apr. 16, 2008), available at <http://www.responsiblelending.org/pdfs/final-caravan-survey-4-16-08.pdf>. An overwhelming percentage of account holders said they would prefer to have their debit card transaction denied than covered for a fee. This was true not only when the purchase is \$5 (80 percent prefer denial), but also when the purchase was \$40 (77 percent prefer denial).

discussed above, the FRB’s recent opt-in rule encouraged banks to engage in deceptive marketing of opt-in and promote it as credit; it did not address the substantive problems with overdraft fees on debit cards. Ending overdraft fees on debit cards and at the ATM would go a long way toward ending excessive use.

Recommendation: *Prohibit banks from charging high-cost overdraft fees on point-of-sale and ATM transactions.*

c. Require that overdraft fees be reasonable and proportional.

The OCC encourages prudent limitations on cost, and we agree. In addressing cost, the OCC cites its longstanding regulation that fees should be based on safe and sound banking principles and notes that reputation and strategic risks should be considered, cautioning against undue reliance on the fees generated by that product. The OCC also recommends that banks identify “any transaction amount below which a fee will not be imposed.”¹³⁸ We support the aim of these recommendations, but we are concerned that they would not result in a decrease in the size of the typical overdraft fee and, as a result, a significant decrease in overall fees charged, particularly to those customers paying the most in fees.

The ten largest OCC-supervised banks typically charge an overdraft fee per transaction of \$35.¹³⁹ This does not include “sustained” overdraft fees that most of the largest national banks also charge if the account is not brought positive within a few days.¹⁴⁰ The typical debit card transaction triggering an overdraft is \$17, and the loan is typically repaid three to five days later when the bank repays itself from the customer’s next deposit.¹⁴¹ And this fee—twice the size of the loan itself—provides the account holder no benefit of avoiding a fee for a declined transaction because, as noted earlier, the cost of a declined debit card transaction is zero.

Recommendation: *The OCC should require that overdraft fees be reasonable and proportional to the amount of the underlying transaction and to the cost to the institution of covering the overdraft.*

¹³⁸ OCC Proposed Guidance, 76 Fed. Reg. 33411.

¹³⁹ See Appendix B. The OCC has long condoned these high fees, and it continues to do so on its website. Its online consumer reference, “HelpWithMyBank,” poses this question: “The bank charged \$34 for an overdraft, which seems excessive. Is there a limit?” The OCC responds that federal laws do not establish maximums, that in some instances these fees are “prescribed by state law,” and that if customers feel their bank’s fees are too high, they should “do some comparison shopping.” <http://www.helpwithmybank.gov/get-answers/bank-accounts/overdraft-fees-and-protection/faq-banking-overdraft-07.html>, last visited August 5, 2011.

¹⁴⁰ See Appendix B.

¹⁴¹ *Debit Card Danger* at 25.

When banks are permitted to earn substantial profits through penalty fees, they have incentives to manipulate consumers into incurring those penalty fees. The OCC’s proposal addresses a number of ways in which banks manipulate consumers to increase overdraft fees: transaction order, disclosures, policies that encourage excess use. We support addressing these tactics but are concerned that, so long as the size of the fee itself is not reasonable, banks will continue to have the incentive to maximize these fees.

Manipulations like those in the overdraft context led Congress to enact a number of reforms to curb the size of over-the-limit and late fees on credit cards. Even before Congress acted, the FRB proposed rules under its authority to address unfair or deceptive practices determining that fees above a reasonable threshold cause substantial consumer injury.¹⁴²

The FDIC’s guidance advises that fees be “reasonable and proportional,” recommending that banks consider eliminating overdraft fees for transactions that overdraw an account by a *de minimus* amount and that, if a fee is charged, it should be reasonable and proportional to the amount of the original transaction.¹⁴³

Notably, the OTS’s proposed 2010 overdraft guidance, which was not finalized before the OTS became part of the OCC, asked whether its final guidance should include a “reasonable and proportional” standard like that required for credit card penalty fees under the Credit CARD Act.¹⁴⁴ It also noted UDAP concerns raised by unreasonable fees.¹⁴⁵

The OCC could use its UDAP enforcement authority under the FTC Act or its safety and soundness authority to support a requirement that fees be reasonable and proportional to the underlying transaction and to the cost to the institution of covering the overdraft, to stop overdraft fees from harming banks’ reputations, their customers, and ultimately, their deposit bases.

d. Limit overdraft fees to six per year.

High-cost overdraft programs, as discussed earlier, are not a legitimate form of routine credit. While we agree with the principle of ability-to-repay, we are concerned that the

¹⁴² The Board took this approach in addressing fee harvester card abuses, concluding that upfront security deposit and fees exceeding 50 percent of the initial credit limit caused substantial consumer injury. 74 Fed. Reg. 5538. It further determined that such costs exceeding 25 percent of the initial credit limit must be charged to the account over six months. The Board’s approach addressed, in part, the problem caused when fees are required to be repaid unreasonably quickly in order to avoid further interest or fees. The same dynamic is at play in the overdraft context.

¹⁴³ FDIC 2010 Guidance on Overdraft Programs.

¹⁴⁴ Department of the Treasury-Office of Thrift Supervision, Proposed Supplemental Guidance on Overdraft Protection Programs, Docket ID OTS-2010-0008, April 29, 2010, 75 Fed. Reg. 22683.

¹⁴⁵ *Id.* at 22687-68.

OCC's discussion of it in the overdraft context suggests that these programs should indeed be considered legitimate forms of credit.¹⁴⁶ Generally, if a customer has a real ability to repay a loan that expensive without taking out another loan, then the customer should be able to qualify for a reasonably-priced legitimate overdraft credit product.

The OCC also advises banks to establish limits on the total amount of fees that may be imposed per day and per month. It further suggests that banks consider conducting a more in-depth analysis of a customer's account after the customer has reached a bank's daily maximum of overdraft fees repeatedly during a month. We agree that overdraft fees should be limited and accounts with repeat fees monitored. However, we are concerned that the suggested limits will legitimize repeat fees, instead of curb them.

Advising a daily limit would endorse multiple daily fees, and if not coupled with cumulative limits and other substantive protections, it would endorse the use of high-cost overdraft programs as routine credit products.

Most of the largest national banks already have a daily limit on overdraft fees of no lower than four, equating to \$140 in fees in a single day.¹⁴⁷ The OCC does not suggest that this limit is too high.¹⁴⁸ The OCC does suggest that a more in-depth review occur after the customer has reached the daily maximum repeatedly during a month. While we support review of customer accounts, this recommendation would effectively condone charging at least \$280 in overdraft fees in a given month (four fees on two different days) before the bank should begin to consider changes to that customer's overdraft usage. This approach stands in stark contrast to the FDIC's recent guidance, which identifies more than six overdraft fees over *twelve months* as excessive.¹⁴⁹

The review process the OCC recommends includes assessing (1) whether the account continues to be viable or (2) whether credit and aggregate fee limits need to be reduced.

¹⁴⁶ The OCC advises banks to consider a customer's ability to repay and manage overdraft credit, including an "initial assessment" of risks a consumer may pose, "as indicated by, for instance, a history of overdrawing an account or information suggesting an inability or unwillingness to repay credit." OCC Proposed Guidance, 76 Fed. Reg. at 33411.

¹⁴⁷ See Appendix B.

¹⁴⁸ The 2005 guidance also recommended daily limits on fees. To the extent large banks implemented daily limits thereafter, they were in the range of ten fees (i.e., \$350) per day. These limits were not lowered until the fall of 2009, as the Board was weighing an out-out rule versus opt-in rule and bills proposing comprehensive overdraft reform had been introduced in both chambers of Congress. See Ron Lieber, Chase and Bank of America Revise Fee Policies, NY Times, Sept. 22, 2009, available at <http://www.nytimes.com/2009/09/23/your-money/credit-and-debit-cards/23credit.html>.

¹⁴⁹ FDIC 2010 Guidance on Overdraft Programs. The OCC notes that another prudent limitation may include a "grace period" of one or days to allow a customer to return the account to a positive balance before any fee is imposed. OCC Proposed Guidance, 76 Fed. Reg. at 33411. We agree this limitation would be prudent but note that for customers paying the most in overdraft fees, who are struggling to make ends meet, a grace period of a day or two will not significantly soften the blow delivered by routine high fees.

The OCC notes that the bank then should take “appropriate action,” including potential termination of “overdraft privileges” or account closure. Our recommendations are aimed at stopping fees *before* they become excessive so that banks avoid the extreme, and extremely unfortunate, result of knocking customers out of the banking system because of banks’ own abusive practices.

Finally, the OCC recommends that banks review accounts that have incurred overdrafts in excess of the overdraft credit limit applicable to the account. As noted earlier, banks should not use fee-based overdraft as a routine, longer-term credit product; it originated as an ad hoc courtesy. We do not know with certainty what typical “credit limits” are, as banks are not transparent about this, but we believe they are often in the \$300-\$500 range, and the OCC does not specify a time period over which banks should base this assessment. Even \$300 over the course of a year, *prior* to the beginning of the review process, would not be appropriate.¹⁵⁰

- Recommendation: *To ensure that overdraft programs are no longer used as routine credit products that drive struggling customers out of the banking system, the OCC should replace its suggested daily limit with a required limit of six per year, where each “sustained” overdraft fee counts as a separate fee.* For whatever brief period banks continue making payday loans, this limit should include overdraft and payday loans combined.

In previous guidances and in this current proposal, the OCC has expressed concern about all the predatory features characteristic of both overdraft and bank payday loan programs, including high cost, short-term balloon repayment, and consequent excessive use.

But the FDIC laid out clearer markers than the OCC has for what constitutes excessive renewals. In the overdraft context, the FDIC identified more than six overdraft fees per year as excessive. This standard is appropriate, and the OCC should prohibit more than six overdraft fees in a year.

In its 2005 payday loan guidance, written at a time when the immediate concern was banks’ partnership with storefront payday lenders through rent-a-bank schemes, and when research on the dangers of payday loans was just beginning, the FDIC advised that any payday debt should be limited to 90 days per year *at the most*,¹⁵¹ the equivalent of six two-week loans or three 30-day ones.

The FDIC’s payday guidance further stated that institutions should offer the customer, or refer the customer, to a more suitable product—but that “[w]hether or not an institution is

¹⁵⁰ In the credit card context, TILA sets a fee threshold at 25 percent of the credit limit during the first year that the account is open. TILA Even without statutory guidance, before passage of credit card reform, the Federal Reserve proposed that fees over the course of a year in excess of 50 of the credit limit were unfair under the FTC Act. 74 Fed. Reg. 5538.

¹⁵¹ FDIC Guidelines for Payday Lending, FIL-14-2005.

able to provide a customer alternative credit products, an extension of a payday loan is not appropriate under such circumstances [i.e., once a consumer has incurred 90 days of indebtedness].”¹⁵²

In the context of payday loans made directly by banks, often to the same customers who are incurring routine overdraft fees, separate standards for overdraft and payday loans are not appropriate because they would allow for routine extensions (i.e. more than six total extensions annually) of short-term credit. Therefore, for any brief period during which payday lending by banks may continue, these loans should be included under the annual cap of six applicable to overdraft fees.

e. Monitor programs closely; rigorously collect and analyze data

The OCC encourages banks to monitor their overdraft programs.¹⁵³ We support this recommendation and further encourage the OCC to closely monitor banks’ programs. We urge data collection and analysis to support the OCC’s rigorous enforcement of the guidance; data should include, but not be limited to, the cost to the institution of covering overdrafts; the number of fees paid by customers with overdrafts; demographics of overdrafters; overdrafts and fees paid from public benefits; and information about whether customers with overdrafts would likely qualify for a lower cost product.

f. Affirmative consent.

The OCC recommends that banks obtain affirmative consent from consumers for overdraft coverage for any type of transaction, including checks and ACH transactions. While affirmative consent should be a baseline protection for any credit product, it does not alleviate the need for substantive protections. Moreover, often, obtaining “affirmative consent” provides lenders cover to engage in abusive practices.¹⁵⁴ This has been clear in the overdraft market post-“opt-in” for debit card and ATM transactions, as well as in the payday, credit card, and mortgage markets for many years.

Recommendations: *The OCC should—*

- *make clear that obtaining consent is not a substitute for providing responsible products;*

¹⁵² *Id.*

¹⁵³ OCC Proposed Guidance, 76 Fed. Reg. 33411-12.

¹⁵⁴ Even in the context of “opt-in” for debit card and ATM transactions, when the Board laid out specific disclosure requirements, including a separate opt-in form, banks have been able to mislead many consumers into opting in. *See Banks Collect Opt-Ins Through Misleading Marketing.*

- *apply an opt-in requirement to both new and existing customers, as no customer should be defaulted into the highest-cost form of overdraft coverage without an opt-in;*¹⁵⁵ *and*
- *require a separate form that lays out all overdraft options, including no coverage, and require that consent be obtained on that separate form.*¹⁵⁶

g. Automatic balloon repayment through setoff.

The OCC's proposal does not address the fact that overdraft loans, and the associated fees, no matter how large the accumulated amount may be, are repaid in full from the customer's next deposit (typically only three-to-five days later). The guidance is also silent with respect to the bank's practice of seizing the customer's funds directly from the checking account—putting itself first in line before all other debt or expenses—even if those funds are protected benefits like Social Security or unemployment payments. *See* Section II.C.1. and Sections IV.B. and IV.C. for our recommendations in these areas.

IV. Bank Payday and Overdraft Practices Violate the Principles, and Often the Provisions, of Federal and State Consumer Protection Laws, Posing Legal and Reputational and Consequent Safety and Soundness Risks.

The OCC's guidance articulates the principle of "legal compliance," noting that any deposit-related credit product must comply with applicable law. In addition to explicit state and federal limits on high-cost loans discussed earlier, other state and federal laws are meant to protect consumers from the kind of harm banks are causing with these products, but banks have attempted to circumvent them, aided by lax federal enforcement. The OCC's guidance should require banks to comply with the letter of these laws, and with the spirit of the principles these laws embody; the OCC's guidance should uphold and support these principles rather than undercutting them.

¹⁵⁵ This is true even if customers may have stronger reasons for wanting some form of overdraft coverage for checks and ACH transactions than they do for ATM and debit card transactions. Moreover, the OCC should remind banks that, under Regulation E, they must give consumers the clear option of electing overdraft coverage only for checks and ACHs and not for ATM and debit card transactions and that they must make clear that there is no fee incurred for a declined debit card transaction.

¹⁵⁶ The OCC appears to condone "opt in" methods that are in fact designed to obtain consent without conscious choice, noting that "banks have flexibility in how they obtain a customer's affirmative request, including through clear and conspicuous language in an application, separate opt-in form, or account agreement whereby the customer affirmatively consents to be enrolled in the program and to pay any related fees for the service." 76 Fed. Reg. 33410. The first and third options—language in an application or account agreement—appear not to require affirmative consent beyond agreement to the account itself.

A. The Military Lending Act Prohibits Payday Loans to Military Service members and Their Families.

See previous discussion at Section II.G.

Recommendation: *For whatever brief period payday lending by banks may continue prior to stronger OCC action, the OCC must advise banks that they must comply with the spirit of the Military Lending Act and stop making payday loans to active-duty military service members and their families.*

B. State and Federal Laws Protect Wages and Exempt Benefits from Garnishment by Debt Collectors.

State and federal law protect wages and exempt benefits from garnishment by debt collectors.¹⁵⁷ The FTC explained that exempt benefits must be protected “to afford minimal protection to debtors and their families by allowing them to retain the prime necessities of life, with a view to preserving the family unit and furnishing the insolvent with nucleus to begin life anew.”¹⁵⁸

The OCC’s 2002 guidance addressing unfair and deceptive acts and practices reminds banks that the OCC has enforcement authority with respect to the Federal Reserve Board’s Credit Practices Rule.¹⁵⁹ That rule explicitly identifies as unfair, and prohibits banks from engaging in, several practices that are functionally equivalent to abusive characteristics of payday and overdraft:

- *Confessions of judgment.* As with a confession of judgment, the lender (in this case, the bank) is able to seize the borrower’s income without judicial process.
- *Waivers of exemption from attachment.* The ability to seize income without judicial process also operates like an exemption waiver, permitting lenders to reach Social Security and other exempt income.
- *Assignments of wages.* A loan based on the ability to take some, or all, of an incoming wage or benefit check is effectively an assignment of wages.
- *Security interest in household goods.* Automatic repayment from the customer’s checking account serves the same terrorizing function as a nonpossessory security interest in household goods.

¹⁵⁷ Even for ordinary wages, under federal law the maximum amount a debt collector can garnish is 25 percent of the borrower’s disposable earnings for that week or the amount by which those earnings exceed 30 times the federal minimum hourly wage, whichever is less. National Consumer Law Center, COLLECTION ACTIONS §§ 12.4.1.1, 12.4.1.4.1 (2008 & Supp.). Many states have laws that protect a greater amount. *Id.* Appx. F.

¹⁵⁸ 49 Fed. Reg. at 7768.

¹⁵⁹ 12 CFR 227.13 (Regulation AA).

Repaying loans by set off when direct deposit is required constitutes a modern day wage assignment.

The Treasury Department recently announced new rules to protect Social Security and other federal benefits from being frozen when debt collectors attempt to garnish bank accounts.¹⁶⁰ But banks—debt collectors in the context of overdraft and payday loans—avoid these laws and rules, and they siphon billions of dollars directly from consumers’ checking accounts every year.

The Treasury Department recently authorized direct deposit of Social Security and other federal payments to prepaid cards. But Treasury was concerned that bank payday loans would siphon off exempt benefits, so the rule bans deposits to prepaid cards that have a line of credit or loan agreement that triggers automatic repayment upon the next deposit.¹⁶¹ The rule was directly aimed at payday loans made through bank prepaid cards.

Unfortunately, this Treasury rule only applies to prepaid cards and not traditional checking accounts. Thus, Social Security, federal disability income, veterans’ benefits and other federal benefits are at risk of being seized by predatory bank payday loans when direct deposited into a bank account. Federal benefits recipients are now required to use electronic payment methods, as paper checks are being eliminated, exposing more vulnerable seniors and others to these dangerous loans.

Recommendation: *The OCC should require that banks stop automatically repaying themselves first from the customer’s next deposit, as it amounts to modern day wage garnishment.*

C. The Truth in Lending Act Prohibits Banks from “Setting off” Credit Card Debt Against Deposits.

The Truth in Lending Act protects the sanctity of deposit accounts against credit card debt: Banks may not repay themselves a customer’s credit card debt by offsetting it against the customer’s deposits with the bank. There is no logical reason that overdraft or bank payday loan debt should be treated any differently.

Until recent changes, Regulation Z under TILA defined “credit card” broadly in ways that could encompass overdraft lines of credit and payday loan products. Recent amendments to Regulation Z—intended to expand the definition of “credit card” to make clear that an account number without a card could fit the definition—had the side effect of excluding

¹⁶⁰ 31 CFR 212.1, effective as of May 1, 2011, available at <http://www.fms.treas.gov/eft/regulations/31cfr212interimfinal.pdf>.

¹⁶¹ 75 Fed. Reg. 80335 (Dec. 22, 2010).

deposit-related credit products from TILA’s credit card protections.¹⁶² But the policy reasons behind protecting deposit accounts from setoff from credit debt continue to apply broadly, and TILA’s credit card definitions could be revisited.

Recommendation: *The OCC should prohibit banks from setting debt off against deposit accounts.*

D. The Electronic Fund Transfer Act (EFTA) Prohibits Creditors from Conditioning Credit on the Consumer’s Repayment through “Preauthorized Electronic Fund Transfer.”

As mentioned in Part II, the Electronic Fund Transfer Act (EFTA) prohibits creditors from conditioning an extension of credit on the consumer’s repayment of that debt by “preauthorized electronic fund transfer.”¹⁶³ But banks believe that they can ignore this prohibition because they structure their payday loans as single payment loans that do not fit within the definition of “preauthorized electronic fund transfer.” That definition requires that the transfer be authorized to recur at “substantially regular intervals.”

But the ban implements an important policy protecting the sanctity of deposit accounts and funds needed for necessities, and that policy helps to avoid unfair and deceptive practices regardless of whether the EFTA specifically applies or not.¹⁶⁴

Moreover, the ban serves not only to protect consumers’ deposits but also to ensure that credit is made based on ability to repay. If a bank does not have sufficient confidence in a consumer’s ability to repay to justify credit without automatic repayment, then that is an indication that the consumer cannot afford further debt. Conversely, an automatic electronic repayment feature leads banks to engage in sloppy—or nonexistent—underwriting, relying on the ability to collect and not the ability of the consumer to repay a loan without entering a cycle of debt—a form of asset-based lending.

Banks are playing both sides of the argument, claiming that their loans are open-ended in order to benefit from lax TILA cost disclosure rules (and avoid the 36% military cap), while claiming the loans are single payment and not recurring to avoid the EFTA ban on conditioning the extension of credit on a requirement to repay the loan electronically. Surely, some of those customers paying \$1,600 annually in overdraft fees or taking out

¹⁶² NCLC filed comments explaining that the proposed rules would inadvertently weaken the protection against offset. The comments are available at http://www.nclc.org/images/pdf/credit_cards/comments-credit-cards-jan-2011.pdf (filed Jan. 3, 2011).

¹⁶³ 15 U.S.C. § 1693k; Reg. E, 12 C.F.R. § 205.10(e)(1). That ban applies to transfers from one account to another account at the same institution, even though such transfers are otherwise outside of the scope of the EFTA.

¹⁶⁴ As discussed above, bank payday loans do recur at regular intervals and thus should be considered to be within the scope of the ban on mandatory electronic repayment.

numerous bank payday loans in one year are repaying their loans at “substantially regular intervals.” And some courts have found that a series of single payment payday loans can be subject to the rules governing preauthorized fund transfers.¹⁶⁵ (On the other hand, if banks assert that these loans are indeed single-payment, not recurring at substantially regular intervals, banks should call them closed-end loans, disclose the appropriate APR, and not offer them to service members.)

Recommendation: *The OCC should enforce the letter and the spirit of the EFTA, including by advising banks not to structure their loans as single-payment to attempt to evade the prohibition against conditioning credit on automatic repayment.*

E. Laws Prohibit Steering and Discrimination in Lending and Require that Banks Serve their Communities.

Customers should not be steered into higher-cost credit than that for which they qualify. The Dodd-Frank regulatory reform bill prohibits mortgage lenders from offering financial incentives for originators to steer borrowers into more expensive mortgage loans than they qualify for.¹⁶⁶ The Federal Reserve’s recently finalized mortgage rules do the same.¹⁶⁷ Steering in the context of other forms of credit is no more appropriate than it is in the mortgage context.

¹⁶⁵ See *Mitchem v. GFG Loan Co.*, 2000 WL 294119 (N.D. Ill. Mar. 17, 2000) (broad language in payday loan agreements authorizing electronic payments “as such amounts come due” suggested repeated or recurring debits even apart from option to roll over loans); *Johnson v. Tele-Cash, Inc.*, 82 F.Supp.2d 264 (D. Del. 1999) (finding that it would offend the EFTA’s primary purpose of protecting consumers if the court were to view payments on a payday loan as single-debit entries and one-transfer-per-note, ignoring the fact that the loans roll over repeatedly with payments recurring at regular intervals), rev’d in part on other grounds, 225 F.3d 366 (3d Cir. 2000) (compelling arbitration); *but cf. Okocha v. HSBC Bank USA, N.A.*, et al., 2010 WL 5122614 (S.D. N.Y. Dec. 14, 2010) (debits to deposit account to offset balance on overdraft account were not preauthorized electronic fund transfers as plaintiff provided “no evidence that these offsets occurred, for example, at weekly, monthly, or annual intervals”).

¹⁶⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203. Section 1403 prohibits a mortgage originator from receiving, “directly or indirectly, compensation that varies based on the terms of the loan, other than the amount of the principal.” It also prohibits originators from steering borrowers from a qualified mortgage (one with generally less risky terms) to a non-qualified mortgage (one with generally riskier terms); to a loan that the consumer lacks a reasonable ability to repay; and to a loan that has “predatory characteristics (such as equity stripping, excessive fees or abusive terms).”

¹⁶⁷ 75 Fed. Reg. 58509, Federal Reserve Board Final Rule, Regulation Z (Sept. 24, 2010), 12 CFR 226.36(e)(1): “In connection with a consumer credit transaction secured by a dwelling, a loan originator shall not direct or ‘steer’ a consumer to consummate a transaction based on the fact that the originator will receive greater compensation from the creditor in that transaction than in other transactions the originator offered or could have offered to the consumer, unless the consummated transaction is in the consumer’s interest.”

The OCC and other federal banking regulators have long acknowledged that overdraft programs are a form of credit, and the OCC does so throughout this proposal.¹⁶⁸ Fee-based overdrafts are more clearly credit now than ever: To encourage account holders to opt in, banks have promoted these programs as an emergency source of funds, and in many cases account holders are choosing to opt in with an expectation that they will be “covered.”¹⁶⁹ So overdraft programs are clearly being marketed as short-term loans, and banks are steering customers into them.

Banks offer a variety of forms of reasonable overdraft protection to customers who apply for it and qualify for it. Checking accounts can be linked to overdraft lines of credit at 16% to 22% APR, to credit cards, and to savings accounts. One national bank making payday loans, for example, has an overdraft line of credit at 21.9% APR and a fee of \$2 per transfer.¹⁷⁰

But banks often steer customers into the highest cost form of overdraft coverage they offer.¹⁷¹ Other customers may apply for reasonably priced overdraft lines of credit but not meet strict underwriting criteria. Banks do not deny those customers credit; instead, they extend them high-cost overdraft credit and/or payday loans at triple- or quadruple-digit APRs with essentially no underwriting, save proof of direct deposit income that can be seized to repay the loan.

This disparate treatment is not risk-based pricing. There is little risk to the institution that any single overdraft or payday loan will not be repaid, since the bank repays itself before any of the customer’s other debts or expenses. Indeed, there is likely *less* risk than with the overdraft line of credit, which can be for much more than the biweekly income and is not repaid automatically.

As described above, a prime consumer with an overdraft line of credit would pay only \$1 for the same amount of credit that cost “Mary” \$448 in overdraft fees. It seems likely that

¹⁶⁸ 2005 Joint Guidance on Overdraft Programs, 70 Fed. Reg. 9129 (“When overdrafts are paid, credit is extended”; OCC Proposed Guidance 76 Fed. Reg. 33409 *et seq* (guidance addressing “consumer credit products such as overdraft protection and direct deposit advance programs”).

¹⁶⁹ For example, TD Bank calls its overdraft coverage the “TD Debit Card Advance.” Claims for its \$35 overdraft program read just like the solicitations for a credit product. “This safety net enables you to make a debit card purchase or ATM withdrawal, even when you do not have enough money available in your checking account.” The bank’s website presents examples of “coverage when you need it most,” including Molly who needs to buy asthma medicine, Mike and Karen who get in trouble with a joint account, Lisa who needs to buy groceries, and Mike who wants cash to go on a date. www.tdbank.com/TDadvance/index.html, (last visited Sept. 26, 2010).

¹⁷⁰ For a comparison of different forms of short term loans, *see* Lauren Saunders, National Consumer Law Center, “Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don’t” (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

¹⁷¹ *See Banks Target, Misplead Consumers as Overdraft Deadline Nears*. The OCC’s proposed guidance notes concern about customers on public benefits being steered into payday loans. 76 Fed. Reg. 33412.

there are serious fair lending implications to charging such astronomical price differences to two set of customers who are likely to have different demographic characteristics. The consumers who are steered into high-cost coverage or who do not qualify for traditional overdraft protection are more vulnerable: lower income, more cash strapped, more heavily minority, more dependent on public benefits.¹⁷² Charging astronomically higher rates to vulnerable consumers is the essence of predatory lending.

Further, the Community Reinvestment Act calls on banks to serve the communities where they take deposits with appropriate products. By making high-cost overdraft and payday loans, banks harm communities of color rather than fulfill these obligations.¹⁷³

Recommendation: *The OCC should—*

- *prohibit banks from operating programs with discriminatory impacts, such as current overdraft and payday programs;*
- *require banks to ensure that tests used to determine who receives lower cost products are not discriminatory and that fair products are available to all consumers;*
- *collect data to identify any fair lending violations and take appropriate enforcement action.*¹⁷⁴

F. State Small Loan Laws Prohibit or Significantly Restrict Payday Lending in Many States.

See previous discussion at II.F.

¹⁷² See Section III.B.

¹⁷³ For impact on communities of color, see previous discussions at Sections II.E. and III.B. See also letters from the Leadership Conference on Civil and Human Rights and other civil rights groups to Wells Fargo and Chase urging them to stop abusive overdraft practices that harm their communities, Nov. 29, 2010: <http://www.civilrights.org/fairhousing/banking/ltr-to-wells-fargo-re-overdrafts-11-29-10.pdf>; <http://www.civilrights.org/fairhousing/banking/ltr-to-chase-re-overdrafts-11-29-10.pdf>.

¹⁷⁴ Both the OCC's 2000 guidance on payday lending and its 2005 joint guidance on overdraft programs caution about risk the products pose under the Equal Credit Opportunity Act (ECOA). The 2000 payday guidance cautions that the product "may foster abusive pricing or discriminatory steering of borrowers to high cost payday loans." The guidance further cautions that failure to comply with ECOA and other fair lending laws may lead to "various administrative actions, including enforcement actions to address violations and to ensure appropriate corrective action; lawsuits; and civil penalties." OCC Advisory Letter on Payday Lending. The 2005 overdraft guidance notes that "steering or targeting certain consumers on a prohibited basis for overdraft protection programs while offering other consumers overdraft lines of credit or other more favorable credit products or services, will raise concerns under ECOA." 2005 Joint Guidance on Overdraft Programs, 70 Fed. Reg. at 9131.

Recommendation: *The OCC must advise banks that they must comply with state small dollar loan laws and that, for whatever brief period payday lending by banks may continue prior to stronger OCC action, banks must not make these loans in states that have meaningful restrictions against payday loans, even if those restrictions apply only to closed-end credit.*

G. State and Federal Laws Prohibit Unfair and Deceptive Acts and Practices.

The OCC has enforcement authority under the Federal Trade Commission Act's ban on unfair or deceptive acts or practices ("UDAP") as to all the banks it supervises, large and small. All banks are also covered by the new ban on unfair, deceptive or abusive practices under the Dodd-Frank Wall Street Reform and Consumer Protection Act. And a number of state laws prohibit unfair or deceptive acts or practices. The OCC notes in its own UDAP guidance that these state laws may be applicable to national banks;¹⁷⁵ they are generally not preempted under either the National Bank Act or the OCC's preemption regulation.

Much of our comment letter addresses unfair practices, but banks making high-cost loans are engaging in deceptive practices as well. The OCC's UDAP guidance cautions against deceptive practices based on principles applied by the FTC: a material representation likely to mislead a reasonable consumer.¹⁷⁶ National banks issuing payday loans disclose that the products are "designed for unexpected short-term credit needs"¹⁷⁷ and that they are "not recommended as a long-term financial solution."¹⁷⁸ These disclosures would lead a reasonable consumer to believe that, since a product is not intended to be a long-term credit product, it likely will not be one. But the data on payday lending by banks paints an exactly opposite picture.

The new ban on "abusive" practices, as defined under Dodd-Frank, is directly under the OCC's authority for banks under \$10 billion. A practice that is abusive is also likely to be viewed as unfair within the OCC's FTC Act authority. We have not focused on the specific definition of "abusive" in these comments but our discussion of unfairness applies equally to abusiveness.

Recommendation: *The OCC should vigorously use its enforcement authority against unfair, deceptive and abusive practices to end payday lending by banks and routine high-cost overdraft loans.*

¹⁷⁵ OCC AL 2002-3 on Predatory and Abusive Lending Practices at 3, note 2.

¹⁷⁶ *Id.*

¹⁷⁷ US Bank Checking Account Advance Disclosures at http://www.usbank.com/cgi_w/cfm/personal/products_and_services/checking/caa.cfm.

¹⁷⁸ Wells Fargo Direct Deposit Service Agreement and Product Guide at <https://www.wellsfargo.com/checking/dda/>.

Conclusion

We appreciate the OCC's attention to bank payday and overdraft practices, which cause serious financial harm to bank customers and pose serious reputational and legal risks to banks. We support the principles the OCC has laid out. We hope the OCC will act quickly and decisively to stop payday lending before it becomes pervasive among banks. We urge the agency to at last put a stop to posting transactions in order from highest to lowest to increase overdraft fees. And we ask the OCC to incorporate our other recommendations into its final guidance. We believe these recommendations are in the interest of the safety and soundness of households and our nation's banks.

We appreciate your consideration of our comments; please do not hesitate to contact us to discuss them.

**APPENDIX A: Bank Payday Loan Products: Overview of Account Terms
Largest Participating OCC-supervised Institutions**

	<u>Wells Fargo</u> ¹	<u>US Bank</u> ²
Pricing	- \$1.50 fee per \$20 borrowed, structured as “open-end” credit - no APR disclosure	- \$2 fee per \$20 borrowed, structured as “open-end” credit - no APR disclosure
Maximum loan amount	50% of total monthly direct deposits up to \$500	50% of total monthly direct deposits up to \$500
Access	Internet; phone.	ATMs; internet; phone; branch.
Default repayment method	Deducted in full from next direct deposit of \$100 or more If direct deposits are not sufficient to repay the loan within 35 days, the loan is automatically repaid anyway even if the repayment overdraws the account.	Deducted in full from next direct deposit of \$100 or more If direct deposits are not sufficient to repay the loan within 35 days, the loan is automatically repaid anyway even if the repayment overdraws the account.
Other repayment methods	1. Payment Plan: Available only to customers who have had outstanding loans in each of the previous three statement periods and have outstanding loan balance of at least \$300. \$100 automatically deducted from each direct deposit of \$100 or more. 2. Payment by Mail: Requires full repayment due 25 days after last statement date, regardless of when the loan was taken out. Also requires \$100 set-up fee that is refunded after two payments are made in full. Is not available for a currently outstanding loan.	Manual repayment: May be made prior to due date, but if not made prior to due date (i.e., prior to next direct deposit or, if those are not sufficient, prior to 35 days after loan was taken out), the automatic repayment still occurs.

¹ Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective April 4, 2011.

² U.S. Bank Checking Account Advance Agreement, July 21, 2011.

	<u>Wells Fargo</u>	<u>US Bank</u>
Cooling off period after repeat use	After 6 consecutive statement periods at maximum credit limit, credit limit is reduced by \$100 each statement period until it reaches zero. After one month at zero, loans may begin again.	After 9 months during which advances have been taken, a 90 day cooling off period.
States available (<i>Italicized</i> states are states with meaningful restrictions on payday loans by storefront lenders.)	The product is “currently only available for accounts opened in Alaska, <i>Arkansas</i> , <i>Arizona</i> , California, <i>Colorado</i> , Idaho, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, <i>Montana</i> , Nebraska, New Mexico, Nevada, North Dakota, <i>Ohio</i> , <i>Oregon</i> , South Dakota, Texas, Utah, Washington, Wisconsin and Wyoming.” ³	The agreement does not state that the product is unavailable in any states. US Bank has branches in <i>Arizona</i> , <i>Arkansas</i> , California, <i>Colorado</i> , Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Minnesota, Missouri, <i>Montana</i> , Nebraska, Nevada, New Mexico, North Dakota, <i>Ohio</i> , <i>Oregon</i> , South Dakota, Tennessee, Utah, Washington, Wisconsin, and Wyoming.
Applicable law per the agreement	“Governed by and interpreted in accordance with federal law and, to the extent state law applies, the law of South Dakota.”	Law of Ohio, as to issues related to interest and related charges
Not intended for long-term use	“We do not recommend regular, repeated use of the DDA service.”	“The Checking Account Advance is designed to fulfill a short-term funds need and not for use as a continuous source of funds for basic financial maintenance . . . By requesting an Advance, you acknowledge and agree that you have had an opportunity to consider other credit products or services and understand the Checking Account Advance to be an appropriate service based on your needs.”
Arbitration	Bank may choose mandatory, binding arbitration	Bank may choose mandatory, binding arbitration

³ <https://www.wellsfargo.com/checking/direct-deposit-advance/overview>.

APPENDIX B: Survey of OCC Bank Overdraft Loan Fees and Terms
Consumer Federation of America
July 2011

Table 1: Overdraft Fees and Limits, Cost of \$100 Overdraft

Name	Initial OD and tiered OD's	Sustained OD fee	OD amount to trigger OD fee	Daily Max OD fees	Total Max Daily OD fees	APR for \$100 2-week OD
Bank of America	\$35	\$35 after 5 days	\$0.01	4 per day	\$140	1820%
Capital One	\$35	None	\$5.01	4 per day	\$140	910%
Citibank	\$34	None	\$0.01	4 per day	\$136	884%
HSBC	\$35	None	\$0.01	Unlimited	Unlimited	910%
JP Morgan Chase	\$34	\$15 after each 5 days	\$5.01	3 per day	\$102	1664%
PNC bank	1 st is \$25 ¹ 2 nd or more is \$36	\$7/day after 5 days; Max of \$98	\$5.01	4 per day	\$144	2574%
RBS Citizens	1 st is \$22 2 nd or more is \$37	\$6.99/day for 4th-13th days overdrawn	\$0.01	7 per day	\$259	2779%
TD Bank	\$35	\$20 on 10 th day	\$5.01	5 per day	\$175	1430%
U.S. Bank	\$10 per item if OD is \$20 or less, \$20.01 or more is \$33 fee per item	\$25/week on 8 th day and each week overdrawn	\$10	3 OD and 3 NSF	\$99 if each OD over \$20	2158%
Wells Fargo	\$35	None	\$5.01	4 per day	\$140	910%

¹ Tiered fees based on overdrafts in last 12 months. Max per day computed using top fee.

Table 2: Overdraft Transactions Covered, Payment Processing, and Overdraft Alternatives

Name	Regulator	Types of transactions covered by OD	Order in which payments are processed	OD protection programs
Bank of America	OCC	Check, online and automatic bill payments, ACH and recurring debit card transactions. ATM transactions if you opt in per use. Does NOT charge OD fee on debit card POS transactions.	At bank's discretion, but ordinarily largest to smallest dollar amount within each category.	\$10 each for transfer from second checking account, savings account, credit card or line of credit.
Capital One	OCC	Checks and automatic bill payments. Non-recurring debit card transactions and ATM withdrawals if you opt in.	By category, then largest to smallest dollar amount.	Offered with savings, credit card, or line of credit.
Citibank	OCC	Check, in person withdrawal, transfer, draft, ACH transaction or electronic transactions. Does NOT charge OD on POS debit or ATM transactions.	At bank's discretion, but generally pay checks smallest to largest dollar amount. ²	\$10 per day for transfers from savings account or line of credit
HSBC	OCC	Checks, can cover preauthorized automatic bill payment. Does NOT authorize and pay overdrafts for ATM transactions and POS debit card transactions.	Generally largest to smallest dollar amount.	Overdraft protection program but no details on website.
JP Morgan Chase	OCC	Check, bill pay, and ACH. ATM and non-recurring debit transactions if you opt in.	Order received for most transactions, all others highest to lowest dollar amount.	\$12 per transfer to credit card, savings account or home equity line of credit.
PNC Bank	OCC	Checks, automatic bill payments, any use of checking account number. ATM and non-recurring debit transactions if you opt in.	Largest to smallest dollar amount.	\$10 per transfer from other deposit account or credit card. Line of credit also available.
RBS Citizens	OCC	Checks, transactions made with checking account number, automatic bill payments. ATM and debit card transactions if	Largest to smallest dollar amount.	\$30 annual fee for OD protection with savings link or line of credit. Plus \$10 daily transfer fee for

² Effective Oct. 14, 2011, Citibank will pay ACH transactions in order of smallest to largest dollar amount.

Name	Regulator	Types of transactions covered by OD	Order in which payments are processed	OD protection programs
		you opt-in.		line of credit
TD Bank	OCC	Check, in person withdrawal, or other electronic means. ATM withdrawals and debit card transactions if you opt in.	First, pending debit card, ATM, or electronic transactions; the rest ordered by category; generally largest to smallest dollar amount within each category.	\$10 per daily transfer. Line of credit at 18% APR.
U.S. Bank	OCC	Check, automatic bill payment, recurring debit card transactions. ATM transactions and non-recurring debit card transactions if you opt in.	At bank's discretion, may process largest to smallest.	\$10 per transfer from other deposit account, credit card, or line of credit. Fee waived if negative account balance is less than \$10.
Wells Fargo	OCC	Check, bill pay, and ACH. ATM transactions and non-recurring debit card transactions if you opt in.	At bank's discretion; generally largest to smallest dollar amount for checks and ACH. Generally in time order for ATM, debit, others; if time stamp not available, lowest to highest.	\$12.50 daily for savings transfer, \$10 for advance from line of credit. Advance from credit card also available for \$10-\$20 per day.