FDIC Consumer News

Summer 2004

Checks and Balances: New Rules, New Strategies for Bank Customers in the 21st Century

Changes are coming that will make it more important than ever to actively manage your checking account to avoid costly mistakes. This is not your father's checking account.

How often do you visit or have some contact with your bank? Chances are you'd say it's only once in a while and certainly not every day. But if you think about it, you probably do have dealings with your bank almost every day through your checking account.

Consider how often you write checks, make deposits (including direct deposits), use your ATM or debit card or make automated payments from your checking account, and you'll be reminded about how much you depend on these services from your bank. According to the Federal Reserve System, Americans write about *40 billion checks a year*. In addition, electronic payments from checking accounts — using a debit card (to deduct payments directly from your bank account), online banking (to pay bills, move money or conduct other transactions using your computer) or other automated services — already outnumber paper checks as a payment of choice (see Page 4).

And while consumers access their checking accounts all the time, we know from the many phone calls and letters we receive that people often have questions or concerns about their checking accounts, including how to resolve errors, avoid bouncing checks, keep fees low and protect against fraud.

Especially important: More changes will be coming as a result of "Check 21," short for the Check Clearing for the 21st Century Act. This law, which takes effect on October 28, 2004, will allow financial institutions to process "substitute checks," high-quality paper reproductions of both sides of original checks. Each substitute check will be created from an electronic image of an original paper check.

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Over time, Check 21 will make check processing faster, and that has real implications for check writers and check depositors. Example: If you currently get your original cancelled checks back with your monthly statement, in the future you may get substitute checks instead.

Given these changes, ***FDIC Consumer News*** offers the following tips and information about what to look for… and what to look out for… when choosing and using a checking account.

1. It's more important than ever to avoid bouncing checks. A check deposited in a bank generally travels by airplane and truck until it reaches the paying bank, typically about one or two days later. As a result of Check 21, more checks will be processed electronically… and faster. That means you need to have enough money in your account when you write a check or run the risk of having checks bounce.

While it's always our advice to have enough money in your account before you write a check, we realize that some people don't always do that — they'll write a check on the 28th of the month expecting their paycheck to be deposited on the 30th of the month, just in time to cover that check. "But if the checks clear sooner as a result of Check 21," says William Henley, Jr., an FDIC electronic banking specialist, "there is a greater risk that a check will bounce if sufficient funds are not in your account when the check is written."

And a bounced check can be costly, with fees typically in the range of $15 to $30 per check.

What can you do to avoid bounced checks? Janet Kincaid, FDIC Senior Consumer Affairs Officer, says the first step is to keep your checkbook up to date. Be sure to deduct ATM withdrawals, bank fees and debit card purchases. Compare your checkbook with your monthly statement. Do *not* rely on your ATM receipt for balance information because it may not reflect outstanding checks or debit card transactions.

"If this is a joint account, make sure you know the dollar amount of each check, ATM withdrawal or debit card transaction that the other person is making, so you don't overdraw the account inadvertently," Kincaid says. "It's hard enough keeping track of things when one person is using the account."

Also, carefully consider the pros and cons of signing up for an overdraft line of credit, which means the bank will automatically cover checks you write (up to an agreed amount) even if you don't have enough funds in the account. You also should be aware that some banks, at their discretion and usually for a fee, may pay overdrafts under certain conditions even if the customer hasn't signed up for a particular program.

These and other overdraft services — and their costs — can vary significantly from bank to bank. "It's really important to remember that this service is essentially a loan so there can be interest charges or other fees," says Kincaid. Also, if you do not pay the overdraft and the bank closes the account, you most likely will have difficulty opening a bank account elsewhere.

The potential for faster check processing as a result of Check 21 has other implications for check writers.

Key Laws Governing Checking Accounts

Here are some common consumer concerns and a look at upcoming changes that may affect you.

Funds availability: One way depository institutions protect themselves against losses from bad checks is to put a "hold" on certain deposits. The Expedited Funds Availability Act of 1987 sets the maximum time periods that financial institutions may hold funds deposited by check before making the money available for withdrawal. Also, the new Check Clearing for the 21st Century Act (called Check 21), which becomes effective on October 28, 2004, will speed up the check clearing process

Erroneous or fraudulent payments: In general, most of the protections against improper payments are covered by state laws, which can vary significantly. Typically, a bank is liable to its customer if it charges its customer's account for a check that is not "properly payable," although state laws also generally require customers to review monthly account statements and report any unauthorized transactions promptly. The new federal Check 21 law, which authorizes banks to pay based on a substitute check instead of an original check, includes provisions for "expedited recrediting" in cases of improper payment. And the Electronic Fund Transfer Act, which governs consumer rights and responsibilities for debit cards, also puts a premium on prompt notification of an unauthorized transfer using your card. Important: If you wait longer than 60 days after the date the bank mails the statement containing the debit card error, you could be liable for the full balance in your account plus any overdraft line of credit.

If you need proof of a payment: Your original cancelled check or substitute check with endorsements provides proof of payment, although images of checks are also accepted often. Under Check 21, your bank may provide you a substitute check that is the legal equivalent of the original check

One is that you may have less time to place a "stop payment" on a check you've written.

2. Expect to get substitute checks from your bank as proof of payment instead of original cancelled checks. For many years, banking institutions have "truncated" checks for some customers. This means the institutions do not return cancelled checks in monthly statements. Instead, they keep original checks for a short period and send statements showing images of cancelled checks. Or, some banks only list check transactions on monthly statements and don't routinely send cancelled checks or images. Now, Check 21 is expected to reduce the instances in which original checks are returned with statements. Here's what's happening:

As before, if you write a check to someone who is not an account holder at your bank, your original check will be deposited at another institution. The check then travels to your bank for payment. But when Check 21 takes effect, the bank where the check is deposited will have two choices. Option one is to return the original check to your bank, as was done in the past. The second option, under Check 21, will be to create an electronic image of the check, produce a substitute check and send it to your bank. This second option means your original cancelled check is no longer available to you.

"Before Check 21, it was your bank that decided whether to return all your original cancelled checks with your statement," says Henley. "Soon your bank may not have the option of returning all your original cancelled checks, even if it wants to."

What if you must prove a disputed payment and your bank has given you a substitute cancelled check, not your original cancelled check? As long as the substitute check meets Check 21's standards, legally it would serve as proof of payment. And what if a bank's substitute check falls short of those standards? FDIC attorney Michelle Borzillo says that "Check 21 provides warranties and remedies to protect parties to the transaction."

Note: Banks have been providing images of checks for decades to millions of customers who do not receive original checks. These images often are accepted as proof of payment by the IRS, courts and other parties provided they meet certain requirements.

3. Protect against check fraud, which is getting increasingly sophisticated. Bank security procedures cannot stop all frauds, which may involve printing or altering checks or obtaining account numbers used to arrange for "payments" from accounts. You can help by promptly reviewing your bank statement each month and immediately reporting any unauthorized transactions. Or, better yet, monitor your account more regularly online or through telephone banking programs at your bank. Timely notification of a problem can limit your potential liability (see Page 2), stop a fraud or assist in an investigation.

Also protect your account information. For example, only give your checking account number, including the routing numbers at the bottom of your check, to businesses you know are reputable. Never provide checking or credit card information, Social Security numbers or other personal information in response to an unsolicited call or e-mail, which could be fraudulent. For more information about Internet "phishing" scams in which thieves use fake Web sites and e-mails to mislead consumers into divulging valuable personal information, see the Winter 2003/2004 issue of ***FDIC Consumer News*** at www.fdic.gov/consumers/consumer/news/cnwin0304/phishing.html.

As a result of Check 21, more checks will be processed electronically… and faster. That means you need to have enough money in your account when you write a check or run the risk of having checks bounce.

Be wary of offers to send money — perhaps to buy something you're selling or forward lottery winnings you've supposedly won — and you're asked to accept a cashier's check for more than the amount due and wire the "excess" money back. The cashier's check often will be counterfeit and you will be responsible for the money you wired to the con artist.

Take safety precautions with your checks, too. Don't carry more checks than you expect to use, keep extra checks in a secure place, and contact your bank immediately if any of your checks are lost or stolen.

And consider direct deposit of your paycheck and other checks you may receive, such as Social Security payments, as a way to prevent them from being lost, misplaced or stolen out of mailboxes. "Direct deposit isn't just safer than handling and mailing paper checks — it's also faster," says Kincaid. "In addition, some banks will reduce their checking account fees if you use direct deposit."

To learn more about how to defend against check fraud and other financial scams, see the Spring 2003 ***FDIC Consumer News*** special report on fraud at www.fdic.gov/consumers/consumer/news/cnspr03/index.html.

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4. Periodically ask yourself, and your bank, if you're getting the best deal. If you think all checking accounts are pretty much alike, you'd better think again.

Your bank probably has several types of checking accounts with different features, fees, yields, minimum amounts to open an account, and other characteristics tailored to certain kinds of customers. And different banks offer different checking products. Checking accounts from the bank down the street or even on the Internet may be more to your liking.

How can you take advantage of this freedom of choice? "First sit down and evaluate your needs, perhaps with the help of a customer service representative at your bank," says Kincaid. Ask yourself: How many checks do I write each month? Do I plan to pay most of my bills without checks, perhaps by phone or over the Internet? Do I use an ATM or a debit card regularly? How much of a balance do I plan to routinely keep in the account?

Perform this kind of review every year or two. Perhaps you'll discover that your existing checking account is still right for you or that switching to a different account (at your bank or elsewhere) could save you money or bring you a better value.

Electronic Payments Surge: How and Why

More consumers conclude that e-checking is cheaper, easier and faster than writing and mailing paper checks

Americans have relied on paper checks as a primary payment method for generations. Yet the latest research from the Federal Reserve System indicates that consumers increasingly are tapping their checking accounts electronically instead of through paper checks.

After rising for many years, the number of checks paid by financial institutions in the U.S. declined from 49.5 billion in 1995 to 42.5 billion in 2000, according to a 2002 study published by the Fed. In contrast, the number of electronic payments (such as automatic bill paying and Internet banking) and debit card payments combined surged from 18.9 billion to 42.8 billion during the same five years.

While fewer checks are being written in the U.S., the number is still very large. Among the reasons Americans still like paper checks: They're familiar and reliable.

"Consumers generally understand how cash, credit cards, and checks work because we can visually see the process and have control," says Robert Lee, a technology specialist in the FDIC's Division of Supervision and Consumer Protection.

Some people also want to have "something tangible to prove you paid for a purchase or to show the IRS agent," Lee adds.

But electronic payments are growing dramatically as more consumers conclude that transacting business electronically is cheaper, easier and faster than writing and mailing paper checks.

Example: "Once online bill payment is set up with your bank," Lee says, "you only need to go online, select the vendor to be paid, choose a due date, key in the amount, and click the pay button."

Other popular electronic alternatives include direct payment programs (in which you authorize your bank to automatically pay bills, such as your mortgage or health club dues) and telephone banking (which enables you to pay bills any time using a touch-tone phone).

Merchants Now Process Checks Electronically

Many stores will accept your check at the sales counter, scan it through a reader, hand the voided check back to you and then use the information from your check to arrange for an electronic fund transfer. A similar process may occur when you mail a check to pay a bill.

For information about what you need to know about this way of quickly processing your check, including your right to receive advance notice of an electronic fund transfer and how to resolve a problem, read the Federal Reserve's brochure *When Is Your Check Not a Check?* at www.federalreserve.gov/pubs/checkconv or the Federal Trade Commission's *E-Checks (Electronic Check Conversion)* at www.ftc.gov/bcp/conline/pubs/credit/echeck.htm.

To Learn More

Changes and new choices in your life as a bank customer can be unsettling or confusing, but you can make the most of the situation by being informed and proactive. If you have a question or a concern about your checking account or the different ways to make a payment, first contact your bank. If you need additional assistance, you can always call or write your institution's federal regulator, which is listed on Page 7.

Kicking the Tires on an Auto Loan: Don't Kick Yourself for Paying Too Much

Buying a new vehicle is stressful enough without having to make a decision about how to pay for it. Zero-percent financing, rebate offers of thousands of dollars, small down payments, bank financing, dealer financing — so many choices are enough to make your head spin even before you've taken your dream purchase out for a spin. ***FDIC Consumer News*** offers these tips to help you save time and money when it comes to shopping for an auto loan.

1. Review your credit report long before you intend to apply for a loan. A credit report is a summary of your financial reliability — for the most part, your history of paying debts and other bills — as compiled by a company called a credit bureau. Why should you see your credit report before applying for a car loan? To correct any error before it slows down your credit approval or prevents you from getting the best possible loan terms. "Erroneous information can cost you hundreds of dollars because you could be disqualified from the best financing terms available," says Joni Creamean, a Senior Consumer Affairs Specialist with the FDIC. "You will be considered a riskier borrower and charged higher rates or be required to provide a larger down payment." Creamean adds that it could take months to correct errors in your credit history.

It's also smart to review your credit report from each of the three major credit bureaus that operate nationwide—Equifax (www.equifax.com), Experian (www.experian.com) and TransUnion (www.transunion.com). Credit report content may vary significantly among the credit bureaus, so that's why experts suggest you request copies from all three companies. The costs of these reports can vary, too. However, beginning December 1, 2004, in western states and moving east with completion scheduled for September 1, 2005, you will be entitled to a free credit report annually under the provisions of the new Fair and Accurate Credit Transactions Act.

2. Shop for a loan before you visit a dealership or bid for a car over the Internet. Contact your bank and several other local lenders. Ask about the loans they offer — the number of months for which you can borrow, the interest rates being offered, whether there are penalties if you pay the loan off early, and so on. Ask about other options for financing the car.

For example, some homeowners may want to consider a home equity loan or line of credit instead of a traditional auto loan. "A loan tied to your home may be available with very attractive terms, and with recent gains in the housing markets many folks have some built-up equity available to use for a new car," says Creamean. A home equity loan also may come with tax benefits (but consult your tax advisor). Important to remember is that if you pledge your home as collateral for a loan, and you can't repay, *you could lose your home*. (For more information, see the new brochure published jointly by the FDIC and nine other federal agencies entitled *Putting Your Home on the Loan Line Is Risky Business*, available on the FDIC's Web site at www.fdic.gov/consumers/consumer/index.html.)

Janet Kincaid, FDIC Senior Consumer Affairs Officer, points to yet another reason to shop for a loan before you shop for a car: "Knowing what your spending limit is and sticking to it permits you to focus only on the vehicles within that range," she says. "This also helps you avoid taking on more debt than you are comfortable with in the long run."

Also consider getting pre-approved for a loan, meaning a lender evaluates your creditworthiness and explains your loan options and likely costs before you buy a car. "Getting pre-approved doesn't mean you have a loan in hand but it does give you the benefit of knowing what you can afford and what it will cost you in the way of a loan," Kincaid explains. "You'll also know you won't be surprised with news that you've been denied credit or charged a higher rate due to your credit record." (Consumer advocates also suggest that you not tell the dealer if you've been pre-approved elsewhere for a loan until after you've negotiated the best price on a car. Some dealers may be less flexible on the price of the vehicle if it's clear that the dealership won't be earning money on a loan.)

After you know what's available in the marketplace, including the interest rates, consider learning what the dealers are offering by reading their advertisements, making phone calls or checking the Internet. Find out if only certain models are eligible for zero-percent financing from the dealer or if a manufacturer's rebate isn't available if you opt for zero-percent financing. Having this information helps you make a good decision about financing when you're face-to-face with a sales

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person or finance officer at the dealership. For example, "In some situations, it may be best to accept the dealer's rebate and pass up the zero-percent financing in favor of a loan from a bank that *does* charge interest," says Creamean. "You'll have to do the math and decide what is best for you."

3. Be careful figuring out how much to borrow and for how long. Of course, the dollar amount of your loan largely will be determined by the sale price of the vehicle minus your down payment, any rebates and the value of any trade-in. But there are other costs that you should consider when deciding how much of a car you can afford and how much of a loan you need. Those costs include auto insurance, sales taxes, annual property taxes on the car (if any), and options you may be inclined to buy, such as an extended warranty. Also remember that every item you add to your loan instead of paying up-front will add to the total cost of the loan because you will be paying interest on the amount financed.

After you determine how big a loan you need, try to pick a repayment period that makes sense for you. For example, a $15,000 loan at 4 percent interest for 36 months equals a monthly payment of $443. Stretch the same loan out to 48 months and the monthly payment drops to $339. While it's tempting to go with a longer loan to reduce your payment, be careful. "Don't make the common mistake of thinking only in terms of monthly payments rather than the total cost of the loan," warns Creamean. "In the end, extending a loan term will cost you more since you will be paying interest on the loan another year or more."

Creamean says to be especially cautious before taking an auto loan term of five years or more. "First," she says, "if you have little cash for a down payment and you have to take on a loan of five or seven years, you might be trying to buy more car than you can really afford. Also, in the later years of the loan, you'll still be making payments on what is an older vehicle that may have a lot of repair and maintenance costs."

Creamean also cautions that, in five or seven years, you may still owe more on the loan than the trade-in value of the car, and that puts you in a difficult financial position. "Just when you need or want a new vehicle," she says, "problems with your old car may require you to come up with extra cash to pay off the old loan or you might have to roll the old loan into a new loan, which may push up your interest rate. It can become a vicious cycle."

4. Know what you are signing and speak up if you think there's a problem. A variety of laws provide consumer protections in the context of auto loans. Among them: the federal Truth in Lending Act, which requires lenders to disclose to borrowers the terms of a loan (including the Annual Percentage Rate and the total cost of the loan), and federal and state laws that prohibit unfair or deceptive business practices. However, you have a responsibility for protecting yourself, too.

"One of the most important things a borrower can do is to carefully review the loan document before signing it, because this is a contract legally binding you to repay according to the terms of the document," says FDIC attorney Mark Mellon. While the Truth in Lending Act gives consumers the right to cancel certain mortgage contracts up to three business days after signing the contract, Mellon says, "there may or may not be a similar protection for your auto loan depending on your circumstances and state law, so it's best to be comfortable with your decision before you sign on the dotted line."

If you have a question or a concern about an auto loan and you can't resolve the matter with the lender or auto dealer directly, contact the appropriate federal regulator — one of the banking agencies listed on Page 7 if the situation involves a banking institution, or the Federal Trade Commission (toll-free 877-382-4357 or www.ftc.gov) for a nonbank lender, such as an auto dealer or finance company.

And for more information about how to get a good auto loan, we recommend the FTC Web site at ww.ftc.gov/bcp/conline/edcams/automobiles/index.html, including the fact sheet "Understanding Vehicle Financing."

The bottom line: By being better informed about auto loans, we believe you're more likely to drive away happy with extra savings in your bank account that can be used for other things, such as gas money… or fuzzy dice.

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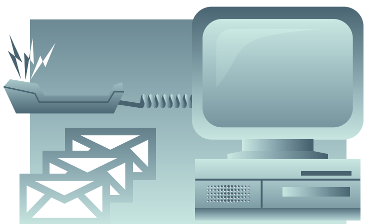

The **Federal Deposit Insurance Corporation** insures deposits at banks and savings associations and supervises state-chartered banks that are not members of the Federal Reserve System. The FDIC's services include a toll-free consumer assistance line, answers to written questions, and informational material. Toll-free phone: (877) ASK-FDIC or (877) 275-3342. The phone line is staffed Monday through Friday, 8:00 a.m. to 8:00 p.m., Eastern Time. Recorded information is available 24 hours a day. The toll-free TTY number for the deaf/hard-of-hearing is (800) 925-4618. Home Page: www.fdic.gov. Mail: 550 17th Street, NW, Washington, DC 20429.

For questions about deposit insurance coverage: Contact the FDIC Division of Supervision and Consumer Protection at the address and phone numbers above or by e-mail using the Customer Assistance Form on the Internet at www2.fdic.gov/starsmail/index.html. The National Credit Union Administration (listed below) insures deposits at federally insured credit unions.

For other questions, including those about consumer protection laws, or complaints involving a specific institution: First attempt to resolve the matter with the institution. If you still need assistance, write to the institution's primary regulator listed on this page. Although the FDIC insures nearly all banks and savings associations in the United States, the FDIC may not be the primary regulator of a particular institution. Other regulators are listed below. To submit a complaint about an FDIC-supervised institution, contact the FDIC Division of Supervision and Consumer Protection as listed above. For inquiries involving problems or complaints related to the FDIC, contact the FDIC Office of the Ombudsman at the mailing address and phone numbers listed above, by fax to (202) 942-3040, or by e-mail to ombudsman@fdic.gov.

The **Federal Reserve System** supervises state-chartered banks that are members of the Federal Reserve System. Phone: (202) 452-3693. Fax: (202) 728-5850. Home Page: www.federalreserve.gov. E-mail: www.federalreserve.gov/feedback.cfm. Mail: Division of Consumer and Community Affairs, 20th Street and Constitution Avenue, NW, Mail Stop 801, Washington, DC 20551.

The **Office of the Comptroller of the Currency** charters and supervises national banks. (The word "National" appears in the name of a national bank, or the initials "N. A." follow its name.) Phone: (800) 613-6743. Fax: (713) 336-4301. Home Page: www.occ.treas.gov. E-mail: consumer.assistance@occ.treas.gov. Mail: Customer Assistance Group, 1301 McKinney Street, Suite 3710, Houston, TX 77010.

The **Office of Thrift Supervision** supervises federally and state-chartered savings associations plus federally chartered savings banks. (The names generally identify them as savings and loan associations, savings associations or savings banks. Federally chartered savings associations have the word "Federal" or the initials "FSB" or "FA" in their names.) Phone: (800) 842-6929 or (202) 906-6237. Home Page: www.ots.treas.gov. E-mail: consumer.complaint@ots.treas.gov. Mail: Consumer Affairs Office, 1700 G Street, NW, Washington, DC 20552.

The **National Credit Union Administration** charters and supervises federal credit unions, and insures deposits at federal credit unions and many state credit unions. Phone: (703) 518-6330. Fax: (703) 518-6409. Home Page: www.ncua.gov. E-mail: pacamail@ncua.gov. Mail: Office of Public and Congressional Affairs, 1775 Duke Street, Alexandria, VA 22314.

Your state government also may offer assistance and publish useful information. Contact your state's Attorney General's office, consumer protection office or financial institution regulatory agency as listed in your phone book or other directories, or visit your state's official Web site.

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New Tax-Advantaged Savings Account for Medical Costs

You should expect to hear more about a new Health Savings Account (HSA) that, for some consumers, could mean big tax breaks when used to save for certain medical costs, including doctor fees and long-term care insurance payments. But not everyone is eligible to open an HSA. Here's a quick summary.

You can set up an HSA at a bank or other U.S. financial institution that offers these accounts. According to IRS rules, your contributions are tax deductible and contributions made by your employer may be excluded from your gross income. The money can remain in the account for years and your earnings grow tax free. Also, there is no tax on the money you withdraw to pay for qualified medical expenses.

In general, to open an HSA you must be under age 65 and have a qualified health insurance plan that has a deductible (i.e., amount you pay) of at least $1,000 (or $2,000 for a family policy). Contributions to HSAs are limited to the amount of your annual deductible. For more information, read IRS Bulletin No. 2004-2 online at www.irs.gov/irb/2004-02_IRB, contact your local IRS office or consult your tax advisor.

How does the FDIC insure these accounts? In general, an HSA deposit account at an insured institution would be protected for up to $100,000 along with any deposits you hold in your name at the same institution — but there are exceptions. To learn more, call or write the FDIC as listed on Page 7.

Insurance Publications

Reminder: The FDIC has issued two new publications to help explain federal deposit insurance coverage. One brochure, *Insuring Your Deposits*, answers basic questions that individuals and families most frequently ask. The other publication, *Your Insured Deposits — FDIC's Guide to Deposit Insurance Coverage*, is a comprehensive guide to the deposit insurance rules.

You can read or download both new publications at www.fdic.gov/deposit/deposits on the FDIC's Web site. Single copies are available free of charge by completing the online order form at www2.fdic.gov/depositinsuranceregister or by calling or writing the FDIC's Public Information Center (Page 7).

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