



The New York City Department of Consumer Affairs'  
Comments to Docket No. R-1343, Regulation E  
Submitted to  
The Board of Governors of the Federal Reserve System

March 30, 2009

## **I. Introduction**

The New York City Department of Consumer Affairs (DCA) and its Office of Financial Empowerment (OFE) appreciate this opportunity to comment on the proposed changes to Regulation E to strengthen consumer protections regarding so-called "courtesy" overdraft programs in regulated financial institutions.

Ensuring fairness in the financial services marketplace requires that consumers have both the information and the opportunity to choose products that they determine to be in their best interest. DCA commends the Board's commitment to improving financial industry practices with regard to courtesy overdraft programs and applauds the Board's recent amendments to Regulation DD to clarify overdraft disclosures and make sure consumers receive accurate balance information.

By amending Regulation E, the Board has the opportunity to definitively address the problem of inadequate information and understanding of overdraft fees embedded in checking and savings account products and to significantly increase consumer confidence and trust in mainstream financial institutions. Of the two possible approaches outlined by the Board, DCA strongly supports requiring consumers to affirmatively consent, or "opt in," to fee-based overdraft protection plans. Consumer choice is the cornerstone of a vibrant marketplace and must be applied to overdraft programs. Further, DCA proposes additional regulatory changes to make certain that consumers are fully aware of fees associated with overdrafts on a transaction by transaction basis at ATM and point-of-sale (POS) terminals, so they can affirmatively choose whether or not to conduct transactions that will incur fees. DCA also supports the Board's proposal to ensure debit holds do not result in costly nonsufficient funds (or "NSF") fees.

## **II. Background on DCA and OFE**

As an agency empowered to enforce municipal consumer protection law and the first local government initiative with an express mission to educate, empower and protect low income people in the financial services marketplace, DCA/OFE sees consumer information and choice as the essence of a fair transaction.

Under the New York City Charter, DCA is charged with planning, making recommendations, conducting research and developing programs for consumer education and protection, and facilitating the exchange and dissemination of information in consultation with agencies, federal and state officials, commercial interests, private groups and others working in this field, and

coordinating the consumer protection activities of other city agencies.<sup>1</sup> Among other functions, the Charter grants DCA the obligation to enforce all laws relating to advertising and offering goods and services, and to receive, evaluate, and investigate consumer complaints.

To ensure a fair and vibrant marketplace for consumers and businesses, DCA licenses over 70,000 businesses in 55 different industries; mediates thousands of individual consumer complaints annually; educates consumers and businesses through press releases, press conferences, educational materials, community outreach and public hearings; and works with other city, state and federal law enforcement agencies to protect consumers from deceptive practices and ensure a fair marketplace.

DCA's Office of Financial Empowerment (OFE) is the first local government initiative in the nation aimed expressly at educating, empowering, and protecting those with low incomes, so they can build assets and make the most of their financial resources. OFE is the first initiative to be implemented under Mayor Michael R. Bloomberg's Center for Economic Opportunity (CEO), a comprehensive, research-driven effort to design and implement innovative poverty-reduction strategies. OFE spearheads an array of efforts designed with potential for scale: protecting New Yorkers with low incomes from unfair and predatory practices, conducting large-scale public education campaigns, implementing innovative asset-building strategies, and coordinating a dynamic citywide network of quality financial service providers.

DCA/OFE's accomplishments include: negotiating with financial institutions to develop a specialized "safe" starter account for low-income participants in the Center for Economic Opportunity's OpportunityNYC program;<sup>2</sup> piloting tax-linked asset-building savings products; launching a multifaceted, city-wide debt awareness campaign; and conducting research on the financial attitudes, behaviors and needs of New York City residents and employees. Partnerships with non-profits and city agencies providing financial counseling and classes through the NYC Financial Education Network give DCA/OFE valuable insight into the impact of credit and banking products. Finally, DCA/OFE is the founder and co-chair of the Cities for Financial Empowerment (CFE) coalition a national network of municipalities working to improve financial services for low-income households. It is this broad and varied experience that informs the present comments.

### **III. Background and Context: Overdraft protection plans are costly financial products that are often used unwittingly by accountholders who can least afford them.**

The high cost and unpredictability of overdraft fees drive people away from banking relationships at a time when our economic revival depends on restoring confidence in our financial system. Recent DCA research on financial attitudes and behaviors of consumers in two low-income neighborhoods of New York City found that one in four checking account holders had overdrawn their accounts at least once in the last few months; 4% reported overdrawing their accounts at least monthly.<sup>3</sup> The 31% of survey respondents who were unbanked - translating to approximately 110,000 residents in 2 communities – cited excessive fees as the

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<sup>1</sup> Chapter 64, Section 2203(a)

<sup>2</sup> The Center for Economic Opportunity has piloted an innovative conditional cash transfer program called "OpportunityNYC." The OpportunityNYC account is a safe and affordable account which makes overdraft virtually impossible. Ten financial institutions agreed to offer this no-fee starter account for participants.

<sup>3</sup> New York City Department of Consumer Affairs, "Neighborhood Financial Services Study: An Analysis of Supply and Demand in Two New York City Neighborhoods," June 2008. This research, conducted during the summer and fall of 2007, includes mapping mainstream and alternative financial institutions, collecting on-the-street surveys of community residents, and facilitating community focus groups. Available at [www.nyc.gov/ofe](http://www.nyc.gov/ofe).

most common reason they avoided mainstream banking.<sup>4</sup> Further, nearly half of those unbanked people (approximately 46,000) held a checking account in the past.<sup>5</sup>

A recent article in *American Banker* supports DCA's conclusions, citing findings from a national study which found that 23 percent of respondents who had switched their bank had done so because there were too many fees.<sup>6</sup> Two-thirds of respondents identified rates and fees as the most important criteria in choosing a new bank.<sup>7</sup>

The fees consumers pay for "courtesy" overdraft protection programs are greater even than fringe financial service providers such as payday lenders. In 2006, financial institutions generated \$17.5 billion in fee income in return for extending only \$15.8 billion through fee-based overdraft coverage.<sup>8</sup> Payday lenders, by comparison, extended \$28 billion in credit in 2005 and collected roughly \$5 billion in fees.<sup>9</sup> These payday loans carry an average annual interest rate of 400%, which has been deemed to violate two-digit interest rate caps in fifteen states, including New York, as well as a federal 36 percent cap on loans to military personnel and their families.<sup>10</sup> Yet, the estimated typical effective annual percentage rate (APR) on fees resulting from ATM and POS/debit transactions is between 1,173% and 3,540%, and states are essentially powerless to enforce consumer protections against nationally-charted banks.<sup>11</sup> At the very least, fee-based overdraft programs should be held to the same standards as the payday lending industry, where consumers affirmatively consent to loan terms.

A recent study by the Center for Responsible Lending found the burden of these exorbitant fees to be concentrated on the least financially stable, with 16% of overdraft loan users paying 71% of fee-based overdraft loan fees and with repeat users more often low-income, single, non-white renters.<sup>12</sup> In addition, FDIC research has found that more than 38% of bank accounts held by customers in low-income areas had at least 1 overdraft, compared to 22% of upper-income accounts.<sup>13</sup>

#### IV. DCA Recommendations

##### **Require that consumers opt in to "courtesy" overdraft protection plans rather than placing the burden on consumers to opt out.**

Both approaches outlined in Proposed Section 205.17 offer a marked improvement over the current lack of consumer information, much less choice, regarding overdraft protection plans. DCA urges the Board to require affirmative consent (opt in) for fee-based overdraft protection plans not only at the point of account opening but on a transaction-by-transaction basis for ATM and POS debit transactions. This option offers considerably stronger consumer protection.

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<sup>4</sup>New York City Department of Consumer Affairs, "Neighborhood Financial Services Study: An Analysis of Supply and Demand in Two New York City Neighborhoods," June 2008.

<sup>5</sup> *Ibid.*, NFS Study.

<sup>6</sup> Malakian, Anthony, "NSF Fees Pay the Bills But Make Customers Bolt," *U.S. Banker*, February 1, 2009.

<sup>7</sup> *Ibid.*, Malakian.

<sup>8</sup> Halperin, Eric and Peter Smith, "Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans," Center for Responsible Lending, July 11, 2007.

<sup>9</sup> King, Uriah and Leslie Parrish, "Springing the Debt Trap: Rate caps are only proven payday lending reform," Center for Responsible Lending, December 13, 2007.

<sup>10</sup> Center for Responsible Lending, "Payday Loans Put Families in the Red," February 2009.

<sup>11</sup> FDIC, "Study of Bank Overdraft Programs," November 2008.

<sup>12</sup> Halperin, Eric, "Overdraft Loans Trap Borrowers in Debt," Center for Responsible Lending, March 18, 2008.

<sup>13</sup> FDIC, "Study of Bank Overdraft Programs," November 2008.

This opt-in requirement, which has been considered best practice by federal regulators since 2005,<sup>14</sup> is entirely feasible. More importantly, it would restore the core component of a fair consumer transaction – meaningful choice – to this critical aspect of basic banking and begin to restore confidence and trust in mainstream financial institutions.

Considerable research supports the argument that consumers want increased choice and information regarding their banking products. DCA focus groups found that unexpected fees were the greatest source of frustration among those who formerly held bank accounts.<sup>15</sup> A national survey released this month found that 83% of respondents wanted to choose whether their bank account included an overdraft protection feature for debit card purchases and ATM transactions, and 80% of respondents wanted their bank to ask permission before enrolling them in a fee-based overdraft program.<sup>16</sup>

Considerable research and experience underscore that an ‘opt out’ model is simply insufficient to ensure that consumers will make decisions in their own best interest. The behavioral economics field has discovered countless examples demonstrating that consumers are unlikely to deviate from the default status. For example, a study of a large U.S. corporation found that 86% of employees who were automatically enrolled in the company’s retirement plan continued to participate in the plan at least three months after being enrolled, compared to a participation rate of 37% for employees with three to fifteen months of tenure who were not defaulted into the plan.<sup>17</sup> Research on privacy policies has also found that although many consumers find it objectionable for companies to buy and sell their personal information, relatively few actually opt-out when given the option.<sup>18</sup>

Consumer choice is a foundation of a fair marketplace; in the vast majority of consumer transactions, consumers are not compelled to decline a service, but rather, must affirmatively select it. Moreover, regulators have not hesitated to bar “negative options” in particular contexts. For example, negative options are not permitted in the context of billing for cable TV services,<sup>19</sup> and should similarly be prohibited here given the much more extreme financial consequences and hardships consumers may face if they are assumed to have tacitly agreed to overdraft protection and fees.

While financial institutions argue that fee-based overdraft coverage saves consumers money on returned checks, nearly 50% of overdrafts result from point-of-sale (POS) debit card transactions or ATM withdrawals.<sup>20</sup> POS and ATM transactions, which require real-time approval from financial institutions, have a median dollar value of \$20 and \$60, respectively, while the median fee they incur is \$27.<sup>21</sup> Moreover, consumer can easily incur multiple fees for transactions which occur in the same day, before they realize that the account is overdrawn. Consumers will still be able to opt in to coverage if they would prefer to incur fees rather than

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<sup>14</sup> OCC, et. al., “Joint Guidance on Overdraft Protection,” February 18, 2005.

<sup>15</sup> New York City Department of Consumer Affairs, “Neighborhood Financial Services Study: An Analysis of Supply and Demand in Two New York City Neighborhoods,” June 2008.

<sup>16</sup> Center for Responsible Lending, “Overdraft Fees and Opting In: A survey of consumer preferences,” March 2009.

<sup>17</sup> Madrian, Brigitte C. and Dennis F. Shea, “The Power of Suggestions: Inertia in 401(k) Participation and Savings Behavior,” *The Quarterly Journal of Economics*, November 2001. The disparity was even greater for employees earning less than \$20,000 a year, with a rate of 80% for those defaulted, compared to 13% for those that had to sign up for the plan.

<sup>18</sup> Sovern, Jeff. “Opting In, Opting Out, or No Options at All: The Fight for Control of Personal Information,” *Washington Law Review*, October 1999.

<sup>19</sup> See 47 U.S.C. § 543(f).

<sup>20</sup> FDIC, “Study of Bank Overdraft Programs,” November 2008.

<sup>21</sup> *Ibid.*, FDIC Study.

risk rejected transactions, but it is imperative that the defaults are changed to require financial institutions to fully explain the advantages of the protection service and the associated fees.

An opt-in requirement for fee-based overdraft programs will be most effective if implemented under the following conditions:

- A. **Transaction types:** Consumer must opt into one-time debit and ATM transactions.
- B. **Real-time choice:** Consumers should have the opportunity to make informed choices about overdraft use at the time of a transaction.
- C. **Written confirmation:** Consumers should receive written confirmation of their overdraft product selection.
- D. **Notifications and ability to change preference:** Consumers who opt in should be notified after incurring NSF fees and be given the option to switch their selection.
- E. **Sample disclosures:** Disclosures should clearly outline the costs of “courtesy” overdraft programs as well as the alternatives being offered.
- F. **Existing accounts:** Consumers with existing accounts should be afforded the same protections offered by opt-in as new accountholders.
- G. **Debit holds:** Consumers should not incur avoidable NSF fees as a result of excessive debit holds.

**A. Transaction types: DCA supports the application of opt-in to one-time debit and ATM transactions**

Both the opt-in and opt-out requirements outlined in the Board’s proposal would apply to one-time point-of-sale debit and ATM transactions. DCA supports the application of the opt-in requirement to one-time debit and ATM transactions. As noted above, these transactions are the most costly, and should, therefore, be covered by the strongest consumer protection, opt-in.

The Board’s own research indicates that consumers are more likely to take advantage of the opportunity to “partially opt out” of overdraft coverage, rather than fully opt out, because they wanted to be sure that more important transactions were covered.<sup>22</sup> Because checks, Automated Clearing House (ACH) transactions and recurring debits “pull” funds from bank accounts, consumers are more likely to be charged fees from payees because of rejected transactions. Given the high cost of fees related to one-time debit and ATM transactions and relative lack of benefits to consumers, DCA supports the Board’s focus on fee-based overdrafts related to these types of transactions.

In addition, DCA recommends that overdrafts caused by check, ACH and recurring debit transactions be defaulted to “opt out,” given that these overdrafts may generally be in consumers’ best interest due to the fees associated with bouncing a check or failing to pay a bill timely. Financial institutions should disclose to consumers whether these transactions are being covered and, if so, give them the option to opt-out. Institutions should also be required to inform consumers about their discretion to offer overdraft protection for these transactions to ensure consumers are fully aware of the transactions to which this protection will be applied.

**B. Real-time choice: Consumers should be notified if a transaction will result in a negative account balance and be able to choose whether or not to employ their fee-based overdraft.**

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<sup>22</sup> “Review and Testing of Overdraft Notices,” Submitted to the Board of Governors of the Federal Reserve System by Macro International, December 8, 2008.

ATM machines and debit terminals should notify consumers that an attempted transaction would overdraw their account, and allow consumers the opportunity to choose whether or not to opt into the transaction and accompanying fee. Currently, the vast majority of banks (81% of banks recently surveyed by the FDIC) allow overdrafts to take place on ATM and POS/debit transactions, and notify consumers only *after* the transaction has been completed (about 89% and 71% of these banks for POS and ATM transactions, respectively).<sup>23</sup> DCA's own research found that 41% of respondents with checking accounts believed their bank would call them if they overdraw their account, indicating widespread misinformation about notification requirements currently.<sup>24</sup> The Board's rules should require institutions to meet these expectations. Consumers should have the opportunity to choose whether to avail themselves of a fee-based service like overdraft, much like the current fee disclosures displayed for out-of-network ATM fees. While implementation at point-of-sale terminals may take some time to implement, it's clear from current ATM notifications that the technology exists and works.<sup>25</sup>

**C. Written confirmation: DCA supports the Board's proposed requirement that consumers receive written confirmation of their selection.**

Proposed Section 205.17(b)(1)(iii) would require financial institutions to provide written confirmation documenting the consumer's choice regarding fee-based overdraft service. Ensuring that consumers are fully aware of the fees associated with their bank accounts is essential to the effectiveness of these amended regulations, and the written confirmation requirement is an important step in doing so. DCA urges the Board to provide sample, plain-language confirmation disclosures to reinforce that consumers are fully aware of their accounts' overdraft coverage.

**D. Notifications and ability to change preference: Consumers who have opted in should be notified when they incur overdraft fees and given the option to change their selections.**

Under Proposed Section 205.17(c), institutions would not be required to provide notification after an NSF fee is assessed on a consumer who opted in to fee-based overdraft. DCA urges the Board to require institutions to provide plain-language notices to all consumers following the assessment of a fee.

In addition to providing real-time choice before a fee is assessed, consumers who have incurred overdraft fees should be given the option to change their status, or "opt out," of fee-based overdraft on one-time debit and ATM transactions going forward. Incurring a fee represents an opportunity for a consumer to reevaluate whether courtesy overdraft is, in fact, in their best interest. Denying such option is hard to justify, particularly when providing notice to consumers with the choice to change their preferences after they incur fees would help to ensure consumers are making their optimal choice regarding the service. This can be provided at minimal cost in the following account statement or immediately follow the transaction.

**E. Sample disclosures: The Board's sample disclosures should fully outline the costs of fee-based overdraft and all other options being offered to consumers.**

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<sup>23</sup> FDIC, "Study of Bank Overdraft Programs," November 2008.

<sup>24</sup> New York City Department of Consumer Affairs, "Neighborhood Financial Services Study: An Analysis of Supply and Demand in Two New York City Neighborhoods," June 2008.

<sup>25</sup> FDIC, "Study of Bank Overdraft Programs," November 2008.

The Board's A-9 Model Consent Form for Overdraft Services can be improved by providing consumers with additional information on the costs of fee-based overdraft and the other options being offered by the financial institution. The form should provide a chart outlining sample effective APRs associated with NSF charges based on the average amount overdrawn and different payoff times to illustrate the costs of such service in relation to the amount of credit extended. Further, the disclosures should include basic information on the other options being offered and the costs of these options in the sample effective APR chart. Clearly outlining the costs and options for each type of transaction covered and service offered will facilitate easy price comparison and sound decision-making by consumers.

**F. Existing accounts: Financial institutions should be held to the same opt-in requirements for both new and current customers.**

Proposed Section 205.17(c) allows financial institutions the option of requiring existing customers to affirmatively consent to courtesy overdraft or, alternatively, to provide opt-out notices to consumers with the first statement for a period in which an overdraft fee is imposed. All consumers should be given the option to choose whether or not to participate in fee-based overdraft before incurring NSF fees for ATM or POS transactions, including existing accountholders who may be unaware of their current enrollment in courtesy overdraft. Further, this alternative would allow institutions to evade the opt-in requirement for existing customers, effectively establishing a separate, opt-out regime. As discussed above, fee-based overdraft is not in consumers' best interest and, therefore, should not be the default option. DCA suggests that the Board requires institutions to obtain affirmative consent from both new and existing customers before imposing NSF fees for one-time debit or ATM transactions.

**G. Consumers should not incur NSF fees as a result of excessive debit holds.**

Proposed Section 205.19 would prohibit institutions from assessing an overdraft fee where the overdraft would not have occurred but for a debit hold placed on funds in an amount that exceeds the actual amount of the transaction, and where the merchant can determine the actual transaction amount within a short period of time after authorization of the transaction. While these holds are prevalent, consumers are often unaware that their available balance has been reduced by such transactions. A Consumers' Union online survey recently found that over ten percent of respondents only became aware that a debit hold was placed on their account after incurring an overdraft fee.<sup>26</sup>

The Board's rule makes significant strides in addressing debit holds, but proposed Section 205.19(b) exempts institutions that adopt procedures to remove holds within two hours of authorization from the prohibition on charging NSF fees as a result of debit holds. While this is important in encouraging institutions to adopt improved settlement practices, consumers may still unduly be charged NSF fees for such holds. The Board should take additional action to ensure NSF fees as a result of short-term debit holds are universally prohibited. The Board should also use its authority under Section 904 of the Electronic Funds Transfer Act to require merchants to promptly submit transactions for settlement to ensure that debit holds placed on accounts for transactions with longer clearing times, such as hotel and car rental deposits, do not excessively tie up account balances.

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<sup>26</sup> Zeichner, Lauren, Letter to Federal Reserve Board of Governor's regarding proposed changes to Regulation DD and Regulation AA, Consumers Union, June 27, 2008.

## **STRONGER PROTECTIONS ARE NEEDED TO ENSURE FAIRNESS IN OVERDRAFT PROTECTION PLANS.**

Beyond providing consumers with choice about fee-based overdraft protection plans, the Board should use this rule-making process as an opportunity to firmly enhance consumer protections related to overdraft transactions. DCA recommends that the Board require the same disclosures for fee-based overdraft programs that apply to other consumer lending products and adopt meaningful limits on the number of NSF fees charged per day.

### **Apply Truth in Lending Act requirements to “courtesy” overdraft plans.**

Through fee-based overdraft programs, financial institutions are effectively extending short-term loans to consumers. Institutions should be required to meet the same established disclosure standards that apply to other revolving credit transactions. In *Smiley vs. Citibank (South Dakota)*, the Supreme Court approved the Office of the Comptroller of Currency’s definition of interest that included credit card fees, such as late payment, over-limit, cash advance, annual and membership fees.<sup>27</sup> These same standards should be applied to overdraft loans, including APR and fee disclosures.

### **Enact meaningful limits on the NSF fees charged.**

As noted above, financial institutions are generating \$17.5 million in fees in return for extending only \$15.8 billion in fee-based overdraft coverage.<sup>28</sup> These fees greatly outstrip the reasonable cost of providing credit, especially given that they are low-risk offerings to customers who often have direct deposits that automatically repay the loans. Moreover, transaction-based fees mean that consumers may face multiple avoidable charges for several transactions conducted in a single day, before they are aware their account has been overdrawn. Daily maximum limits would strongly encourage financial institutions to create innovative solutions to ensure that people were not able to continue spending and accumulating thousands of dollars in NSF fees while their account lacks sufficient funds.

## **VI. Conclusion**

DCA acknowledges the Board’s continued commitment to ensuring that costly “courtesy” overdraft fees are applied fairly and with the full knowledge of consumers. Consumer knowledge and choice are the essence of a fair transaction. While the Board’s recent amendments to Regulation DD make important strides in improving fairness and transparency in overdraft plans, additional steps should be taken to enable consumers to minimize their exposure to these often unanticipated fees. The Board should require financial institutions to obtain affirmative consent from all customers, new and existing, before enrolling them in fee-based overdraft protection for ATM and POS transactions and ensure that fees are not applied unfairly as a result of transaction clearing practices and debit holds. In addition, the Board should consider further rulemaking to require credit-based disclosures and enact meaningful limits on high-cost overdraft lending.

The current economic downturn illustrates the need for intelligent regulation and thorough oversight of the financial services industry. As consumers and banks alike are facing increasing economic instability, the Board can have a significant impact on the recovery and the future strength of the financial system by enacting regulations that increase fairness and address

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<sup>27</sup> *Smiley v. Citibank (S.D.), N. A. (95-860), 517 U.S. 735 (1996)*.

<sup>28</sup> Halperin, Eric and Peter Smith, “Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans,” Center for Responsible Lending, July 11, 2007.



information asymmetries in the marketplace. Such reforms will both protect consumers and aid in the economic recovery by increasing the use of mainstream banking products.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Jonathan Mintz', with a stylized flourish at the end.

Jonathan Mintz  
Commissioner  
New York City Department of Consumer Affairs