

BUREAU OF CONSUMER FINANCIAL PROTECTION

[Docket No. CFPB- 2012-0007]

IMPACTS OF OVERDRAFT PROGRAMS ON CONSUMERS

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Notice and Request for Information.

SUMMARY: Title XIV of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (the Dodd-Frank Act), charges the Bureau of Consumer Financial Protection (the CFPB or the Bureau) with regulating “the offering and provision of consumer financial products or services under the Federal consumer financial laws.”¹ Specifically, the Dodd-Frank Act grants regulatory authority to the Bureau for the Electronic Funds Transfer Act,² except with respect to section 920 of that Act, and the Truth in Savings Act,³ which taken together, in part, govern consumer transaction accounts. Accordingly, the Bureau is reviewing existing regulations and supervisory guidance issued by various regulators pertaining to the use of overdraft programs by financial institutions. To support this review, the Bureau seeks information from the public on the impact of overdraft programs on consumers.

The Bureau encourages comments from the public, including consumers, overdraft program processors, and financial institutions.

DATES: Comments must be received on or before **[INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]** to be assured of consideration.

¹ 12 U.S.C. 5491(a).

² 15 U.S.C. 1693 et seq.

³ 12 U.S.C. 4301 et seq.

ADDRESSES: You may submit comments, identified by Docket No. CFPB-2012-0007, by any of the following methods:

- <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Email: cfpb_overdraft_comments@cfpb.gov
- Mail: Monica Jackson, Office of the Executive Secretary, Bureau of Consumer Financial Protection Bureau, 1500 Pennsylvania Ave, NW, (Attn: 1801 L Street, NW), Washington, DC 20220.
- Hand Delivery/Courier: Monica Jackson, Office of the Executive Secretary, Consumer Financial Protection Bureau, 1700 G Street, NW, Washington, DC 20006.

Instructions: The CFPB encourages the early submission of comments. All submissions must include the document title and docket number. Please note the number of any question to which you are responding at the top of each response (respondents need not answer each question). In general, all comments received will be posted without change to <http://www.regulations.gov>. In addition, comments will be available for public inspection and copying at 1700 G Street, NW, Washington, DC 20006, on official business days between the hours of 10 a.m. and 5 p.m. Eastern Time. You can make an appointment to inspect the documents by telephoning 202-435-7275. All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Sensitive personal information such as account numbers or Social Security numbers should not be included. Comments will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT: For general inquiries, submission process questions or any additional information, please contact Monica Jackson, Office of the Executive Secretary, 202-435-7275.

SUPPLEMENTARY INFORMATION:

Background

Technological Advances in Transaction Accounts: With changes in technology, the number of ways in which consumers can access funds in a checking account has expanded over decades from paper checks to include automated teller machine (ATM) withdrawals, point-of-sale (POS) debit card use, preauthorized debit card use, Automated Clearing House (ACH) payments, and online banking transactions. This expanded range of accessing funds also means that the number and types of transactions potentially causing an overdraft has increased as well.

When checking accounts were accessed exclusively or predominantly through paper checks, institutions generally declined to pay an item if there were insufficient funds in the account to cover that item; instead, the item would be returned and the consumer would be charged a returned check or non-sufficient funds (NSF) fee. Before returning an item, some institutions would conduct a manual review and, as a courtesy, pay certain items based on the institution's relationship with the consumer.

Over the past decade or more, many institutions introduced automated overdraft systems under which overdraft items are paid, subject to tolerances or limits that are established at the account level, and an overdraft fee is charged on a per item basis. A study published in 2008 by the Federal Deposit Insurance Corporation (FDIC) of

overdraft practices among banks it supervised⁴ found that more than two-thirds of surveyed banks with assets of \$250 million or more had automated overdraft programs.⁵ The FDIC study found that overdraft and NSF fees accounted for 74% of the deposit service income of banks with automated overdraft programs during the 2006 study period.⁶

While not based on a representative sample of banks, the FDIC's analysis of account-level data found that the approximately 9% of accountholders who incurred 10 or more overdrafts annually bore approximately 84% of overdraft-related fees.⁷ Those who incurred over 20 overdrafts per year – representing 4.9% of all consumers – incurred fees of over \$1,600 per year on average.⁸ The FDIC study also concluded that the most frequent overdrafters were disproportionately low and moderate income and more likely to be young adults.

Regulatory Actions since Completion of the FDIC Study

Amendments to Regulation DD: On January 29, 2009, the Board of Governors of the Federal Reserve System (Board) published final regulations amending Regulation DD, which implements the Truth in Savings Act, effective January 1, 2010.⁹ These amendments require all institutions to provide additional periodic statement disclosures of overdraft fees and fees for returning items unpaid. They also restrict institutions'

⁴ FDIC *Study of Bank Overdraft Programs* (“FDIC Study”); Washington, DC, November, 2008, available at <http://www.fdic.gov/bank/analytical/overdraft/>.

⁵ FDIC Study at Table III-1, page 5.

⁶ FDIC Study at page 56. “NSF-related” income included fees for items returned due to all fees referred to as “overdraft fees” in this document, including fees for items declined due to insufficient funds (“NSF fees”), paid overdraft items (“overdraft coverage fees”) and fees for not repaying paid overdraft items for a certain period of time (“extended overdraft fees”).

⁷ FDIC Study at page 76.

⁸ FDIC Study at page iv.

⁹ 74 FR 5584 (July 29, 2009). The CFPB restated Regulation DD at 12 CFR part 1030. 76 FR 79276 (Dec. 21, 2011).

ability to provide “padded” balance amounts (i.e., including amounts institutions may make available through their overdraft coverage programs) in response to balance inquiries using automated systems such as ATMs, online banking and voice response units.

It is uncertain what impact these changes to Regulation DD have had on consumer behavior or on the incidence of overdrafts or related charges to consumers

Amendments to Regulation E: On November 17, 2009, the Board published final regulations amending Regulation E, which implements the Electronic Fund Transfer Act, effective January 19, 2010.¹⁰ These amendments prohibit financial institutions from charging fees for transactions that overdraw an account by use of a debit card at an ATM and point-of-sale unless the consumer opts in to permitting the institution to authorize and pay overdrafts on these transactions. In so doing the Board noted that “the cost to consumers of overdraft fees assessed in connection with ATM and debit card overdrafts is significant” and “may substantially exceed the amount[s] overdrawn.”¹¹ And based upon research that it conducted, the Board found that “many consumers may not be aware that they are able to overdraft an ATM or POS” and may therefore “unintentionally overdraw their account.”¹² Based on consumer testing, the Board further found that many consumers “would prefer to have ATM withdrawal and debit card transactions declined if they had insufficient funds, rather than incur an overdraft fee.”¹³

There is disagreement about the impact that this regulatory change has had. For example, a 2011 industry survey of 18 large banks found that only 16% of consumers had

¹⁰ 74 FR 59033 (Nov. 17, 2009). The rule had a delayed mandatory compliance date of July 1, 2010. The CFPB restated Regulation E at 12 CFR part 1005, 76 FR 81020 (Dec. 27, 2011).

¹¹ *Id.* at p. 59038.

¹² *Id.* at pp. 59038-59039.

¹³ *Id.* at p. 59039.

opted in for overdraft coverage on ATM and debit card transactions.¹⁴ In contrast, Moebs Research estimated that, as of March 2011, 75% of consumers had opted in for such overdraft coverage.¹⁵ Further, consumer groups have raised concerns about the manner in which some institutions promoted the opt-in option to their existing checking account customers. For example, one group's survey of consumers found that "only 33 percent of accountholders opted-in to overdraft coverage, and most who did based their decision on information that was deceptive."¹⁶

Recent FDIC and OCC Supervisory Guidance: Subsequent to the amendments to Regulations DD and E taking effect, the prudential regulators have expressed ongoing concern about overdraft programs.¹⁷ In November 2010, the FDIC issued supervisory guidance to "assist FDIC-supervised institutions in identifying, managing and mitigating risks associated with overdraft payment programs."¹⁸ The FDIC guidance addresses, among other things, the marketing and disclosure practices surrounding automated overdraft and alternatives to overdraft and also the basis on which overdraft charges are assessed, including check-clearing procedures.

In August 2010, the FDIC also issued guidance stating that overdraft payment programs are subject to the requirements of the Equal Credit Opportunity Act (ECOA) as

¹⁴ Consumer Bankers Association Press Release, October 27, 2011, which can be viewed at <http://www.cbanet.org/news/PRdetail.cfm?ItemNumber=19595>.

¹⁵ Moebs Services press release, March 8, 2011 which can be viewed at <http://moebs.com/PressReleases/tabid/58/ctl/Details/mid/380/ItemID/199/Default.aspx>.

¹⁶ Center for Responsible Lending: *Banks Collect Overdraft Opt-ins Through Misleading Marketing; April, 2011, page 2, available at <http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/CRL-OD-Survey-Brief-final-2-4-25-22.pdf>*.

¹⁷ The prudential regulators had previously expressed concerns about overdraft programs in 2005. See 70 FR 8428 (Feb. 18, 2005) (OTS overdraft guidance) and 70 FR 9127 (Feb. 24, 2005) (OCC, FDIC, Board, and NCUA joint overdraft guidance).

¹⁸ FIL-81-2010: *Overdraft Payment Programs and Consumer Protection Final Overdraft Payment Supervisory Guidance*, November 24, 2010, available at <http://www.fdic.gov/news/news/financial/2010/fil10081.html> (FDIC Final Guidance).

implemented through Regulation B. Specifically, the FDIC adopts the 2005 joint Guidance on Overdraft Protection Programs, stating 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 overdraft services, will raise concerns under the ECOA.”¹⁹

In June 2011, the Office of the Comptroller of the Currency (OCC) proposed guidance to “detail[] the principles that the OCC expects national banks to follow in connection with any deposit-related consumer credit product.”²⁰ The OCC’s proposed guidance includes an appendix that “illustrate[s] application of these principles to ... automated overdraft protection products.”²¹ The proposed guidance states that the “OCC is concerned with several practices that have developed” with respect to overdraft programs including “potentially misleading statements” in marketing; “failure to assess a customer’s ability to manage and repay overdraft protection before it is made available to the customer”; “failure to ... identify excessive usage”; and “payment processing intended to maximize overdraft and related fees.”²²

The FDIC and OCC based their supervisory guidance on safety and soundness concerns, but raised significant consumer protection issues as well.²³ The FDIC Final

¹⁹ FDIC, Financial Institution Letter, (August 11, 2010) (citing the 2005 Joint Guidance on Overdraft Protection Programs adopted by the Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; National Credit Union Administration), <http://www.fdic.gov/news/news/financial/2010/fil10047a.html>.

²⁰ *Guidance on Deposit-Related Consumer Credit Products* 76 FR 33409 (June 8, 2011) (OCC Proposed Guidance).

²¹ *Id.* p. 33409.

²² *Id.* p. 33411.

²³ Separately from the FDIC and OCC, the Office of Thrift Supervision (OTS) specifically addressed consumer financial protection concerns in proposed supplemental guidance it issued in April 2010 to OTS guidance issued in 2005 on overdraft programs. For example, the OTS noted that savings associations should avoid practices it labeled as deceptive, such as marketing an account “without informing consumers of significant overdraft fees associated with an account” or failing to disclose certain transaction ordering policies and the effect they may have on the frequency with which overdrafts might occur. The OTS also

Guidance expressly noted that overdraft programs “include[d] risks that could result in serious financial harm to certain consumers.” Similarly, the OCC predicated its proposed guidance “on the premise that bankers should provide their customers with products they need, and that bankers should not use their products to take advantage of their customer relationship.”²⁴

While the OCC document has not been finalized, the proposal is materially different from the FDIC guidance. Indeed, after the OCC issued its proposed guidance, the American Bankers Association wrote to the Bureau and to the prudential regulators (including the OCC) urging the development of a “uniform set of supervisory expectations”²⁵ and forwarding comments urging “consistent regulatory treatment for similar products.”²⁶

Request for Information

The Bureau seeks additional and updated information from the public, including consumers, third party processors, and financial institutions, regarding overdraft programs and their costs, benefits and risks to consumers. This information will enable the Bureau to better understand and evaluate any potential consumer protection issues raised by overdraft programs.

In the questions that follow, we use the terms “overdraft” and “overdraft fee” broadly to refer to practices followed and fees charged when a consumer initiates a

suggested that failing to “limit fees for consumers who frequently overdraw their accounts” could be unfair as “these consumers may not be able to avoid the harm caused by high overdraft fees;” for example, “those who frequently overdraw accounts may simply not have other options in the market, as they may have credit histories and other characteristics that prevent them from obtaining less expensive services.” 75 FR 22681 (April 29, 2010).

²⁴ OCC Proposed Guidance, 74 FR at 33410.

²⁵ American Bankers Association letter to FDIC, OCC, Federal Reserve Board of Governors, and CFPB, August 24, 2011 viewable online at <http://www.aba.com/aba/documents/news/OverdraftLetter82511.pdf>.

²⁶ American Bankers Association letter in response to OCC proposed guidance August 4, 2011 viewable online at <http://www.aba.com/aba/documents/news/OCCGuidanceLetter8411.pdf>.

transaction for which there are insufficient funds in the consumer's checking account. Specifically, the term overdraft fee includes fees charged for a returned check (e.g., an NSF fee), fees charged when an overdraft item is paid (i.e., an overdraft coverage fee), and fees charged if an overdraft is not repaid within a specified period of time. The questions are grouped into six broad categories: (a) lower cost alternatives to overdraft protection programs offered by financial institutions, (b) consumer alerts and information provided regarding balances and overdraft triggers, (c) impact of changes to Regulation DD and Regulation E and overdraft opt-in rates, (d) impact of changes in financial institutions' operating policies, (e) the economics of overdraft programs, and (f) the long-term impact of overdraft programs on consumers. Please feel free to respond to all of the questions or only those that interest you, but please be sure to indicate in your comments which questions you are answering.

Lower Cost Alternatives to Overdraft Protection Programs:

1. What alternatives do institutions offer to overdraft protection programs and how much do consumers make use of these alternatives? Among other things, comments could address the availability and utilization of alternatives to traditional overdraft fees – for example, linked savings accounts or overdraft lines of credit – especially among those who incur overdraft charges on their checking accounts.
2. To what extent do consumers avail themselves of alternatives to incurring overdraft fees?

3. How are consumers informed of alternatives to overdraft protection programs and how are such alternatives marketed to new customers, existing customers, and to particular customer segments?
4. What portion of the most frequent overdrafters – those who would benefit the most from alternatives – would qualify for a linked savings account (i.e., have a savings account) or line of credit (i.e., pose acceptable credit risk)?

Consumer Alerts and Information Provided Regarding Balances and Overdraft Triggers:

5. What opportunities do financial institutions offer consumers to sign up for alerts via text message and/or e-mail that inform consumers when their balances are low and, thus, when payment transactions might put them at risk of incurring an overdraft? The Bureau is interested in programs and technologies that make consumers aware at the time they engage in a transaction that they may incur an overdraft fee. Among other things, comments could address:
 - a. The extent, if any, to which consumers are given the opportunity to be alerted to and avoid a transaction that would cause an overdraft fee;
 - b. The marketing of, participation rates in, and impact on consumers, of such alert programs, particularly among those who are likely to incur overdraft fees;
 - c. The way account balances are communicated generally in response to routine ATM or telephone inquiries;
 - d. The extent to which communicated balances differ from available balances and whether these differences affect consumers' ability to avoid incurring overdrafts; and

- e. The balance calculations – e.g., available vs. actual balances –used to determine when an overdraft has occurred in end-of-day batch processing.
6. Whether a particular transaction will incur an overdraft fee depends upon the interaction of various terms, rules, and practices, including those governing funds availability, the posting order of debits and credits, the amount by which an account must be overdrawn to trigger an overdraft fee, the number of overdraft fees that can be incurred in a single day, and whether the fee is one-time or for each day the account remains in overdraft status. Comments could include information regarding how these are communicated to consumers and the extent to which consumers understand them. For example:
- a. In what ways are consumers informed of the rules and practices that determine which transactions will cause overdraft fees to be incurred? When they enroll in an account? As part of notices that they have incurred an overdraft?
 - b. Is there any customer research available that documents consumers' perceptions regarding how transactions are processed, when overdrafts are incurred, and when related fees are charged?
 - c. What changes in consumer behavior or understanding of overdrafts have resulted from the changes that took effect in Regulation DD in 2010?

Impact of Changes to Regulation DD, Regulation E, and Overdraft Opt-In Rates:

7. The Bureau is interested in the impact of the changes to Regulation E that took effect in 2010 on consumers. Among other things, comments could address:

- a. What were the variations across institutions in opt-in rates among consumers with accounts as of July 1, 2010? What variations in opt-in rates occur now among institutions? What differences in marketing and disclosures practices may be responsible for differences in opt-in rates?
 - b. How did opt-in rates vary based upon prior usage of overdraft? Were there significant variations between non-overdrafters, occasional overdrafters, and frequent overdrafters (e.g., those who incurred 10 or more overdrafts in a year)?
 - c. How did the opt-in rates vary based upon average account balance or demographic characteristics, such as income, age, or education level?
 - d. How do the overdraft frequencies of consumers who opted in differ from those who did not?
8. The Bureau is interested in learning how institutions are conducting outreach to customers who incur overdrafts repeatedly, what policies have been implemented to manage both the risks and needs such customers may present, and which options are given to such customers. The Bureau is aware that some institutions may charge fees based on accounts being overdrawn, notwithstanding the customer's request to close the account, and would like to understand what impact this practice may have. Among other things, the Bureau is particularly interested in hearing more about:
 - a. The extent to which consumers are permitted to close existing accounts when there are outstanding overdraft fees;

- b. The consequences to consumers of keeping accounts open that have outstanding overdraft fees and what additional fees consumers accrue; and
- c. The practices that can best serve consumers who have incurred negative balances while protecting institutional safety.

Impact of Changes in Financial Institutions' Operating Policies:

9. The Bureau is aware that some institutions have recently changed their order of processing transactions in various ways, including, for example, adoption of a purely chronological system of posting debit transactions; adoption of a system that separates different types of debit transactions (e.g., ATM and point of sale debit, ACH, check, and various account fees) and applies different rules to order transactions in discrete buckets; and adoption of a system which orders debit transactions from smallest to highest dollar amount. The Bureau is interested in learning how these changes have affected consumers. Comments could include information regarding:

- a. The different ways in which institutions currently group and order different types of transactions;
- b. How institutions disclose the ways in which they currently group and order transactions;
- c. The consequences in practice of different grouping and ordering policies for the frequency with which consumers may incur overdrafts and related fees. Or the consequences for whether certain overdraft items will or will not be paid; or

- d. The impact of funds availability policies on when overdrafts are determined to have occurred.

10. In addition to transaction ordering policies, the Bureau is also aware that some institutions have adopted other new policies with respect to overdrafts. For example, some institutions have declined to permit consumers to opt in to overdraft coverage of electronic debits and instead reject those transactions or allow consumers to opt in at the point of the transaction. Other institutions have adopted cushions on the amount by which an account must be overdrawn to incur an overdraft fee; caps on the number of fees that may be incurred in a given day; tiered overdraft fees; a grace period to cover an overdraft item without incurring a fee; or a waiver of fees on a certain number of overdraft items per month. In what way do such changes— or other new policies with respect to overdraft — affect the incidence and/or severity of overdraft charges?

The Economics of Overdraft Programs:

11. The Bureau is interested in the economics of overdraft programs, including their contribution to overall costs and revenues associated with checking accounts. There is concern based on the FDIC study's data from 2006 that many institutions are reliant on fees from a small group of frequent overdrafters for a disproportionate share of revenue from checking accounts, while many other accountholders benefit as "free riders."²⁷ The Bureau is interested to learn the

²⁷ For example, one consulting firm estimated that the 26 percent of checking accounts in which overdraft fees occur and the 23 percent of accounts with balances over \$3000 are responsible for the vast majority of bank revenue (the former based on overdraft fees and the latter based on interest earned on deposits) while the remaining 51 percent of accounts were unprofitable, earning less in fee income and interest than it cost the banks to service them. (Celent blog posted March 10, 2010, viewable at <http://bankingblog.celent.com/?p=1261>).

extent to which the FDIC study's findings from 2006 are representative of the market today. At the same time, the Bureau also seeks to learn what costs regulations affecting overdrafts might impose on institutions. Comments may address, among other things:

- a. How the distribution of overdraft revenue from consumers may have evolved since the FDIC study and the implementation of changes in Regulations DD and E;
- b. The distribution of overdraft fees by type of transaction (check, ACH, debit, ATM, etc.) today relative to what the FDIC found in its study;
- c. The extent to which different groups of consumers incur overdrafts and related fees disproportionately (for example, the FDIC study suggested that young adults and consumers with low or moderate incomes might incur overdrafts more frequently than other groups);
- d. The share of deposit service fees charged to consumer accounts that are attributable to overdrafts and NSF's today;
- e. The costs to institutions of administering overdraft programs; and
- f. The losses (e.g., charge-offs) that occur as a result of extending overdraft coverage.

Long-term Impact on Consumers:

12. The long term impact of overdraft programs on consumer behavior and options is of particular interest to the Bureau. Some have argued that overdraft programs allow consumers to meet liquidity challenges while others argue that overdraft eventually adds to liquidity issues because of the high recurring fees that frequent

overdrafters must pay. Further, there is concern that heavy use may lead a significant percentage of users to damage their credit records in databases institutions use to qualify consumers for checking accounts and thereby to lose access to the services of competing providers or to the banking system altogether.

To what extent are these various perspectives valid?

Dated: February 22, 2012

Meredith Fuchs,

Chief of Staff, Consumer Financial Protection Bureau.