

The New York City Department of Consumer Affairs'
Comments to Docket No. R-1315, Truth in Savings
Submitted to
The Board of Governors of the Federal Reserve System

July 18, 2008

I. Introduction

The New York City Department of Consumer Affairs (DCA) appreciates the opportunity to comment on the rules the Board of Governors has proposed in its Docket No. R-1315.

Overdraft fees exceed \$17 billion annually, of which nearly \$8 billion comes from ATM and debit card purchases that could have been declined.¹ Almost one-half of all overdrafts result from ATM or PIN-based Point-of-Sale (POS) transactions which could be easily prevented or disclosed to the consumer but are not.² Given the staggering national financial impact, consumers deserve transparency and choice when making financial decisions.

DCA recognizes the Board's commitment to improved disclosures for "courtesy" overdraft protection plans when opening accounts and in periodic statements and overdraft payment notices. The disclosures and opt-out provisions contained in the proposed changes to Regulation DD represent a significant step towards improved consumer fairness and financial institution accountability, but fall short of establishing the disclosure of full information and active consumer consent that could avoid unanticipated fees. The limited scope may cause financial institutions to shift fees to more typical overdraft lines of credit, which are exempted from these rules.

DCA proposes several additional regulatory changes within the Board's rule-making power, focused on ensuring that consumers are fully aware of the fees associated with overdraft and can make informed choices to accept those fees both at the time of account opening and on a transaction by transaction basis at ATM and point-of-sale terminals.

II. Background on DCA

DCA submits its comments as the city agency empowered under the New York City Charter to "plan, make recommendations, conduct research and develop programs for consumer education and protection, and facilitate 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 coordinate the consumer protection activities of other city agencies."³ Among other functions, the Charter also grants DCA the obligation to enforce all laws relating to advertising and offering goods and services, and to receive, evaluate, and investigate complaints.

To ensure a fair and vibrant marketplace for consumers and businesses alike, DCA licenses 55 categories of businesses; mediates thousands of consumer complaints annually; educates consumers and businesses through press releases, press conferences, educational materials, community outreach and public hearings; and works with other city and law enforcement agencies to protect consumers from unfair and deceptive practices.

¹ Eric Halperin 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.

² 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, January 25, 2007.

³ Chapter 64, §2203(a).

DCA enforces the City's landmark Consumer Protection Law to prevent consumers from being defrauded in the marketplace. The Department's aggressive enforcement against such industries as major wireless companies, tax preparers, electronics stores and secondhand auto dealers has ensured that consumers are protected from deceptive or misleading marketing practices and are provided with information to make meaningful market choices.

As a consistent and vocal proponent for meaningful disclosures across a range of industries, DCA implements and enforces local laws requiring clear and conspicuous disclosures. For example, home improvement contractors, licensed by DCA, must provide written contracts with itemized lists of labor and materials, a schedule of payments linked to project milestones, and notices of cancellation that consumers can execute. Similarly, consumers using paid tax preparers in New York City are protected by DCA's Consumer Bill of Rights Regarding Tax Preparers which entitles them to receive a statement describing the tax preparation service with estimates of total costs and the date when the refund will arrive, before becoming obligated to any tax preparer.

DCA's impact on consumer disclosures is broad and extends beyond businesses licensed by the Department. For example, DCA petitioned the New York State Public Service Commission to improve disclosure requirements for energy service providers, yielding promising preliminary rules. DCA's rule-making and enforcement power, combined with effective consumer education, makes it a powerful advocate for more than eight million New Yorkers and millions of tourists.

DCA's Office of Financial Empowerment (OFE) was the first initiative launched by the Mayor's Center for Economic Opportunity (CEO), an ambitious and aggressive multi-pronged anti-poverty effort. OFE is dedicated to educating, empowering and protecting New Yorkers with low incomes to help them retain income and build assets. OFE's accomplishments include: negotiating with financial institutions to develop a specialized "safe" starter account for low-income participants in CEO's OpportunityNYC program⁴; piloting asset-building savings products for EITC recipients at tax time; and conducting research on the financial behaviors and attitudes of New York City residents and employees. OFE also regularly convenes financial education providers and stakeholders under the auspices of its Financial Education Network and recently launched a website with an online, searchable directory of financial education providers. DCA's partnership with non-profits and city agencies providing financial counseling and classes gives it valuable insight into the impact of overdraft protection plans. Finally, OFE is a founder and co-chair of a national network of municipalities working to improve financial services for low-income households, called the Cities for Financial Empowerment. It is this broad and varied experience that informs DCA's comments.

III. Background and Context: Overdraft Protection Fees Have Steadily Increased in Cost and Affect the Most Vulnerable New Yorkers.

The large financial impact of overdraft fees is disproportionately concentrated among the most vulnerable: the young, the elderly and those with the lowest incomes. With debit cards and overdraft protection widely available even to young people who may not have stable incomes and a sophisticated understanding of personal finance, the risk of overdraft penalties is particularly high. In 2007, the *Detroit Free Press* identified examples of college students and young military personnel who incurred hundreds of dollars in fees because of inadvertent, debit-based overdrafts.⁵ The elderly are also especially vulnerable to unanticipated overdraft: those relying on Social Security income⁶ pay nearly \$1 billion in fees for

⁴ CEO has piloted an innovative conditional cash transfer program called the "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. To date, more than 1500 accounts have been opened.

⁵ Susan Tompor. "Please Take a Seat, Students; This is Debit Card Usage 101." *Detroit Free Press*, August 26, 2007.

⁶ This is especially egregious given that federal benefits are prevented from freezes by judgment creditors. Because overdrafts are not considered loans, banks are able to recoup on the funds as well as the fees directly from the deposit of federal benefits. DCA aggressively supported legislation passed this session in the New York State Senate

unauthorized overdrafts, according to one consumer advocacy organization.⁷ Overall, Americans 55 and older pay \$4.5 billion in overdraft fees.⁸

Recent DCA research on financial attitudes and behaviors of consumers in two low-income neighborhoods of New York City (Melrose, Bronx and Jamaica, Queens) found that one in four checking account holders surveyed had overdrawn their accounts at least once in the last few months; 4% reported overdrawing their accounts at least monthly. With overdraft fees averaging \$30, residents within these two communities are paying upwards of \$3.8 million annually just to cover overdrafts.⁹ Also, research from the Center for Responsible Lending found that repeat overdraft users are more likely than one-time users to be non-white, single and have low incomes.¹⁰

While the greatest effects of overdraft protection fall on the most vulnerable, “courtesy” overdraft protection fees are a concern for all American consumers. Overdraft fees exceed \$17 billion annually.¹¹ National research suggests that the short timeframe of overdraft protection plans translates to APRs higher than 4,000%, and that overdraft protection plans are linked to an increased number of overdrafts.¹² The Government Accountability Office (GAO) found that overdraft fees were the highest fees reported by financial institutions, often ranging from \$30 - \$40.¹³

Slow check-clearing policies on deposits combined with instant debits from ATM and debit cards have also increased the complexity of account management. The GAO found that 47% of overdraft fees result from ATM or PIN-based Point-of-Sale (POS) transactions which could be easily prevented or disclosed to the consumer but are not.¹⁴ Given the staggering national financial impact, consumers deserve transparency and choice when making financial decisions.

IV. Proposed Amendments and DCA Recommendations

Full and timely disclosures are critical for consumers to make informed decisions about their account management. Proposed disclosures increase consumer information, but are not timed to effectively improve behavior.

The Board proposal recognizes that consumers are often enrolled in “courtesy” overdraft protection plans without their knowledge, despite the fact this is typically more expensive than overdraft lines of credit or linked accounts that could serve the same purpose.¹⁵ Moreover, this proposal recognizes that consumers are often unaware of the overdraft fees they are charged, and that unintended overdrafts result in a significant accumulation of fees. DCA/OFE’s research has confirmed consumers’ lack of information

and Assembly (The Exempt Income Protection Act, Bill A.8527A/S.6203B) to require financial institutions to examine the source of funds for federal exemptions before responding to a freeze notice.

⁷ Leslie Parrish and Peter Smith. “Shredded Security: Overdraft Practices Drain Fees From Older Americans.” Center for Responsible Lending, June 18, 2008.

⁸ Ibid.

⁹ 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. (Hereafter “Neighborhood Financial Services Study.”) Available at www.nyc.gov/ofe Calculations based on 2000 Census population of Jamaica, Queens and one monthly overdraft for those who reported overdrawing their account at least once per month.

¹⁰ Lisa James and Peter Smith. “Overdraft Loans: Survey Finds Growing Problem for Consumers.” CRL Issue Paper No. 13. Center for Responsible Lending, April 24, 2006.

¹¹ Eric Halperin 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.

¹² Marc Anthony Fusaro. “Hidden Consumer Loans: An Analysis of Implicit Interest Rates on Bounced Checks.” *Journal of Family and Economic Issues*. Vol. 29 No. 2, June, 2008.

¹³ Government Accountability Office. “Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts.” Report GAO-08-281, January 2008. Pg 2

¹⁴ GAO, 2008. 8

¹⁵ As “courtesy” overdraft protection plans increase in amount, frequency and automation, they are taking on the characteristic of loans. DCA recommends that the Board consider applying Truth in Lending (TILA) disclosure requirements to these plans.

regarding overdrafts. Forty-two percent of consumers in DCA/OFE's Neighborhood Financial Services Study erroneously believed that their financial institution would "call to warn [them] if [they] write a check that would overdraw [their] account." The Board's own study in 2003 found that nationally, 38% of consumers surveyed answered this question incorrectly.¹⁶ Clear, plain-language disclosures are critical to a fair and vibrant marketplace, a core component of the Department's operating principles.

In the financial sector, improved disclosure could actually increase market size by helping to attract the un- and under-banked who have avoided mainstream banking. The Neighborhood Financial Services Study found that 31% of residents in Melrose and Jamaica are unbanked, and 42% of survey respondents currently unbanked previously held a checking account.¹⁷ Moreover, 38% of all unbanked respondents cited fees as a reason to avoid banking. Consumer focus groups identified "unexpected fees" as a primary reason to avoid banking and participants expressed the sense that financial institutions misled them about banking fees. As a result, consumers expressed the belief that financial institutions were not honest brokers. The Board proposal, combined with the strengthened disclosure DCA proposes below, could empower consumers to gain or regain trust with mainstream financial institutions and increase the total pool of customers for the industry.

DCA proposes several regulatory changes within the Board's rule-making power that could significantly amend the practice of automatically enrolling accountholders in the most expensive of overdraft options without their explicit permission and reduce the likelihood of unintended overdrafts that cost consumers billions of dollars each year. These changes include:

- A. Providing upfront disclosure of terms and conditions of overdraft protection plans;
- B. Requiring that consumers opt in to overdraft protection plans rather than placing the burden on the consumer to opt out;
- C. Requiring accurate balance information through all customer interfaces;
- D. Requiring disclosure at ATM and Point-of-Sale terminals if a transaction will overdraw their account; and
- E. Requiring prompt notification of overdraft occurrences.

A. Full upfront and continuous disclosure of terms and conditions of all overdraft protection plans offered is crucial to enable consumer choice.

The Board's proposal establishes, in Section 230.10, requirements for opt-out disclosure notices at institutions that offer such an opt-out. The notice would state the categories of transactions that could result in overdraft fees, the costs of the overdraft service, and any limits on the overdraft fees that may be assessed, both daily and during a statement period. The notice would also inform consumers about how to exercise their opt-out right, and if alternatives to overdraft protection exist, such as lines of credit.

It is critical to empower consumers to make informed choices and to facilitate meaningful comparisons of "courtesy" overdraft protection plans across financial institutions. To enhance these protections, DCA suggests that the Board consider requiring financial institutions to disclose the availability of linked accounts for overdraft purposes, as this is often the least expensive option for consumers. Further, the Board should require disclosure of fees in terms of effective Annual Percentage Rate (APR) based on typical repayment periods for de facto overdraft protection loans.

Finally, while disclosures are critical, they will not prevent financial institutions from charging exorbitant fees for "courtesy" overdraft protection plans. With increasing fees and the commonplace usage of debit cards as outlined above, DCA urges the Board to consider developing rules limiting the number of transactions that may be charged an overdraft fee or the total dollar amount of fees that can be charged on a given day.

¹⁶ Marianne A. Hilgert, Jeanne M. Hogarth, and Sondra G. Beverly. "Household Financial Management: The Connection Between Knowledge and Behavior." *Federal Reserve Bulletin*, July 2003.

¹⁷ 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. Available at www.nyc.gov/ofe

B. Require that consumers opt into “courtesy” overdraft protection plans rather than placing the burden on the consumer to opt out.

The Board proposes required notification of new consumer rights proposed under amendments to Regulation AA, which would require financial institutions to provide consumers the right to opt out of overdraft protection plans before being charged an overdraft fee.

DCA supports the Board’s proposal to require that opt-out notification be prominently featured along with fee notification to ensure that consumers recognize that they have the right to stop overdraft protection. DCA also agrees with the Board that the timing of opt-out notices should coincide with any notice informing the consumer that an overdraft fee was paid, as indicated in Section 230.10(a). The proposed rule may provide a needed wake-up call to consumers struggling to manage their finances, and help financial education providers and credit counselors reach consumers in need.¹⁸ This particularly may be true for consumers with limited banking experience, such as students and workers with low incomes. DCA urges the Board to require that the opt-out notice appear in close proximity to the fee disclosure. Proximity can have a sizable impact on the likelihood of reading and reacting to the notification.¹⁹

Nonetheless, considerable research supports the power of default options to influence consumer behavior; many more people will use overdraft protection plans if they are allowed to be automatically enrolled than if consumers made the choice themselves.²⁰ DCA urges the Board to insist that financial institutions use default options that are in consumers’ best interests. Because “courtesy” overdraft protection plans have high fees that are often applied without consumer knowledge or consent, these plans do not meet the standard of consumer interest that should be applied to default options.

Consumers must be allowed to affirmatively select overdraft protection, rather than have this feature selected for them if they are silent. 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,²¹ 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.

All disclosures on the opt-in agreement, as in any consumer agreement, should be made in plain language, identifying both the actual dollar fee amount per overdraft and an effective APR based on those fees and the time period prior to repayment.

¹⁸ DCA’s Office of Financial Empowerment has developed a network of financial education providers who provide one-on-one counseling, workshops and classes to help people manage their finances. DCA regularly convenes this group and has an online, searchable directory for consumers that lists over 40 service providers in New York City. More information is available at www.nyc.gov/ofe

¹⁹ New York City local rules, developed and enforced by DCA, require that when the use of the word “free” is used, terms and conditions must be clearly and conspicuously disclosed in close proximity to that word. (Rules of the City of New York, Title 6, § 5-06(b). The Board should also ensure that disclosures in a sufficiently large and clear font to be legible to consumers, as illustrated by the sample disclosure provided in the proposed rules.

²⁰ See, for example, literature on automatic retirement enrollment such as William G. Gale, J. Mark Iwry, and Peter R. Orszag. “The Automatic 401(k): A Simple Way to Strengthen Retirement Savings.” Policy Brief No. 2005-1, The Retirement Security Project. This study found that average participation rates for employees earning less than \$20,000 annually in firms with automatic enrollment are 80%, compared to 13% under the traditional “opt-in” system. Available at: [http://www.retirementsecurityproject.org/pubs/File/Automatic401\(k\).pdf](http://www.retirementsecurityproject.org/pubs/File/Automatic401(k).pdf)

²¹ See 47 U.S.C. § 543(f).

C. Require financial institutions to provide accurate balance information through all customer interfaces.

Section 230.11(c) of the Board's proposal requires that institutions provide accurate balance information through automatic inquiries such as ATMs, automated telephone systems, and Internet banking portals, disclosing only funds that are available for immediate use or withdrawal and not any additional amounts that are provided through overdraft protection plans. The proposal suggests, but does not require, that accurate balance information also reflect deposits not yet available for withdrawal and holds for ATM and debit card transactions. The proposal does not require similar accurate balance information for person-to-person contact.

Even if the Board declines to adopt DCA's proposal that it prohibit automatic enrollment in overdraft protection plans, it should impose more rigorous requirements with regard to disclosures that can influence consumers' actions before a fee is incurred.

While accurate balance information is a basic requirement that will help consumers be better equipped to monitor and manage their bank accounts to avoid overdrafts generally, DCA urges the Board to consider applying this rule to all consumer interfaces, including person-to-person interactions. Restricting accurate balance requirements to electronic inquiries would allow for misrepresentation to exactly the vulnerable populations it hopes to protect – the elderly and consumers with low incomes who may prefer “high-touch” customer service interfaces. DCA urges the Board to consider establishing protocols for what would be considered a “misleading” or “deceptive” statement during such inquiries.²² Further, accurate balance information should clearly differentiate between available and actual balances, ensuring that check processing delays do not cause consumers to overdraw their accounts.

Disclosure alone cannot address the problem of overdrafts related to payment processing timing. DCA urges the Board to restrict financial institutions from applying overdraft fees if funds are on deposit, regardless of whether checks have been processed. The 2008 GAO report indicated that while many transactions take place rather quickly, certain deposits may be held for up to eleven days.²³ DCA also encourages the Board to consider, as suggested in its proposed amendments to Regulation AA, mandating that financial institutions process smaller withdrawals before larger ones, preventing consumers from arbitrarily large overdraft charges when large transactions clear first. Both of these provisions would ensure that overdraft fees only apply in cases where it is clear to both the consumer and the institution that available funds do not exist.

D. Require disclosure at ATM and Point-of-Sale (POS) terminals if a transaction will overdraw the account.

Section 230.10(c)(1) of the Board's proposal requires that the consumer be notified of the right to opt out of overdraft protection before being charged any insufficient fund fees. The Board's commentary implies that this clause is only applicable to account opening.

Just as consumers rely on their financial institutions for accurate reports of their account balance, they expect that their institution will provide ample warning if a transaction is being processed that will incur fees and create a negative account balance. But, the proposed rules remain silent on just-in-time disclosures that would allow consumers to make a meaningful choice on whether they are willing to pay a fee in order to process a given transaction. The Board should require financial institutions to display a warning to consumers at the ATM or Point-of-Sale (POS) terminal that a requested transaction will cause the account balance to drop below \$0 and will incur a non-sufficient funds fee, and allow the consumer an opportunity to opt out of the transaction before it is processed. While DCA recognizes the technological hurdles faced by merchant payment

²² The subprime mortgage crisis is rife with accounts of loan applicants being given incorrect or misleading information when speaking to brokers in person. For example, a 2007 *New York Times* article found that homeowners facing foreclosure were told incorrect mortgage terms in person, although their documents were in fact correct. See Ford Fessenden. “The American Dream Foreclosed.” *New York Times*, October 14, 2007.

²³ GAO 2008, 21.

networks in adopting this requirement, a 2008 GAO analysis found at least one financial institution that is already offering this service on its proprietary network.²⁴ Similar to the current ATM fee disclosures, this type of disclosure allows a consumer to make a meaningful decision about whether or not to incur a fee and could dramatically decrease inadvertent debit or ATM-based overdrafts.

E. Require prompt notification of overdraft occurrences

The Board's proposal, in Section 230.10(c)(2), specifies that opt-out notices be provided following an overdraft occurrence, either in a separate notification or as part of the next periodic statement, acknowledging that offering opt-out only at account opening may not be effective. The Board's proposals also require total cost disclosure for overdrafts on a per-period and per-calendar year basis, as described in Section 230.11(a).

While DCA acknowledges the importance of the proposed opt-out notice and periodic fee calculation, it is concerned that the Board does not require immediate notification of overdrafts, as outlined in its own 2005 guidance on overdraft protection programs.²⁵ Prompt notification of overdrafts is crucial, especially given that the terms of overdrafts are rarely disclosed. Consumers have little information about the length of time they are given to repay the overdraft coverage, and are often charged a daily or periodic rate for maintaining a negative balance. Rather than allowing for an initial overdraft notification to be sent either with the statement or immediately following an overdraft, the Board should require notification before any periodic fees are applied to overdrawn accounts (often applied at five days). The Board should define "prompt" notification as not more than three calendar days from the overdraft incident. Moreover, as a best practice, the Board should encourage notification via e-mail, SMS message or other forms of speedier communication.

Disclosure provisions should apply to all overdraft-related fees, including those associated with lines of credit or savings transfers.

As written, disclosures would apply only to "courtesy" overdraft protection plans and not to fees associated with overdraft protection provided by lines of credit or savings account transfers. While Section 230.10(b)(6) requires that the institution state the presence of alternatives, including lines of credit, it does not extend disclosure requirements to these alternatives.²⁶ A cursory examination of bank accounts available in the New York metropolitan area finds that transfer fees range from \$5-\$20.²⁷ While these fees are lower than "courtesy" overdraft protection fees, consumers of both services should nonetheless be made aware of their option to opt out of these services and given sufficient information about the fees they pay in order to make informed financial choices. Financial institutions should not be able to circumvent the Board's intended consumer protections by steering consumers to other overdraft products.

V. Conclusion

DCA acknowledges the strides that the proposed rules make towards improved disclosures and practices related to "courtesy" overdraft protection plans, and appreciates the Board's acknowledgement of the multi-billion dollar financial burden placed on consumers by "courtesy" overdraft protection plans. These rules, however, fall short of requiring full information and active consumer consent that could avoid unanticipated fees. In order for consumers to make informed decisions in their own best interests, the Board must require financial institutions to provide upfront disclosure of terms and conditions of all

²⁴ GAO 2008, 60.

²⁵ OCC et al. "Joint Guidance on Overdraft Protection Programs." February 17, 2005. Available at: <http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050218/>

²⁶ While overdraft lines of credit are covered by disclosures required through Regulation Z, the Truth in Lending Act, new disclosures proposed here, such as per-period and per-calendar fees on periodic statements, would not apply.

²⁷ www.findabetterbank.com, accessed June 20, 2008

overdraft protection plans including savings transfers; allow consumers to opt into “courtesy” overdraft protection rather than placing the burden on the consumer to opt out; provide accurate balance information through all customer interfaces; create warnings at ATM and Point-of-Sale (POS) terminals if a transaction will overdraw the account; and immediately notify consumers of overdrafts when they occur.

Beyond disclosures, DCA also urges the Board to consider the systemic issues that lead to abuses of overdraft protection by reevaluating check-clearing policies and the ordering of financial transaction processing. Through a combination of disclosures and regulation of predatory practices, the Board can improve the financial services marketplace and ensure that consumers are treated fairly. A fair and vibrant marketplace will attract a larger overall market to mainstream banking, including those who have turned to fringe financial services providers out of fear of overdraft fees.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Jonathan Mintz', written in a cursive style.

Jonathan Mintz
Commissioner
New York City Department of Consumer Affairs