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July 28, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th St. and Constitution Ave., N.W.
Washington, DC 20551

Re: Docket No. R-1197; Docket No. OP-1198
Interagency Guidance on Overdraft Protection Programs

Dear Ms. Johnson,
I am writing from the California Reinvestment Coalition (CRC) to comment on the interagency guidance on overdraft protection programs.

The California Reinvestment Committee is a nonprofit membership organization of more than two hundred nonprofit organizations and public agencies across California. CRC works with community-based organizations to promote the economic revitalization of California's low income and people of color communities. CRC promotes increased access to credit for affordable housing and community economic development, and to financial services for these communities. CRC has agreements with California's major financial institutions.

We commend the Federal Reserve Board, along with the four other federal regulatory bodies, for addressing the issue of bounced check loans. We agree that many aspects of the marketing, implementation, and disclosure of these programs are of concern to consumers at large. However, the proposed guidance will not protect consumers from a risky "service" that effectively amounts to a short-term, high-rate loan program akin to payday lending. The banking industry insists that bounced check loans are a helpful feature that consumers demand and benefit from. This claim ignores, however, the high levels of fee income that banks collect from unsuspecting consumers, many of whom are unaware they are enrolled in a bounced check loan program. Furthermore, the ills of bounced check loans disproportionately affect low-income people, the very groups community organizations are working to bring into the banking mainstream. Current bounced check loan programs lower the quality of bank retail accounts, this reducing their advantage to consumers over check cashing stores.

We believe stronger regulation is needed on bounced check loans, and we sense the issue is a more serious concern to consumers than the Federal Reserve Board suspects. Our main conclusion is that bounced check loans ought to be regulated under the Truth in Lending Act (TILA) rather than the Truth in Saving Act (TISA). TILA coverage would require that banks disclose the Annual Percentage Rate (APR), solicit the affirmative assent of the consumer before enrolling them in a bounced check loan product, and ensures private right of action.

Marketing. The advertising materials of banks seemingly encourage customers to behave irresponsibly; these institutions promote the program as if it were a line of credit, rather than a last-ditch attempt to avoid a negative balance. A survey performed by the Consumers' Federation of America provides a more comprehensive analysis of banks' misleading advertisements (complete results are discussed in their separate letter). Their findings show that 34% of the sample advertisements contained language that encouraged customers to overdraw their accounts. Additionally, 54% concentrated their efforts on the guarantees of coverage more heavily than the discretionary nature of the product.



Implementation. We have found that most banks offering bounced check loans engage in questionable practices that will raise the likelihood and frequency of costly overdrafts. First, recent versions of bank software are designed to cash a customer's largest checks first, which increases the number of subsequent overdraft fees from smaller checks and transactions. Second, many banks now display a "cash available" figure rather than an "account balance" at ATM terminals and on monthly statements. In actuality, the "cash available" figure is the sum of the account balance and the overdraft limit, which misleads the customer into supposing (s)he has more money in the account. Third, no data exist to show that banks are eliminating the program from repeat users. Banks are taking a serious financial risk by extending a type of credit to all accountholders without performing credit scores or any form of underwriting.

Recommendations. Simply stated, when an overdraft is paid, credit is extended. In fact, in the proposed Interagency Guidance and Best Practices, the Federal Reserve Board explicitly admitted these products are an extension of credit.¹ However, a provision in Regulation Z states that fees for paying overdrafts are currently not considered finance charges if the institution has not agreed in writing to pay overdrafts. Enacted under the auspices of TILA, this regulatory exemption was originally intended for the occasional ad-hoc payment of overdrafts. The exemption has since been exploited by the banking industry: with the subsequent automation of financial services, banks are now able to apply this service to virtually all of their accounts and charge exorbitant fees for its use. This regulatory provision seems even more outdated given the technological changes in the industry, most notably the increased use of ATMs, debit cards, and internet transactions.

Changes in technology necessitate changes in regulation. Bounce check loans therefore should be covered under the Truth in Lending Act (TILA) as opposed to the Truth in Savings Act (TISA). As discussed above, bounce check loans clearly constitute "credit" and the banks that offer them are "creditors." Because of the expensive costs of bounce check loans, consumers ought to have Annual Percentage Rate (APR) disclosures. Improved disclosure of APR or relevant fees would ensure better consumer knowledge, and allow for comparison among the wider range of loan products available on the market. Even stronger "When overdrafts are paid, credit is extended... since this regulatory exemption was created for the occasional ad-hoc payment of overdrafts, its application to these automated and marketed overdraft protection programs could be reevaluated in the future." (Interagency Guidance on Overdraft Protection Programs, 28 May 2004).

CRC does not explicitly oppose overdraft programs in general. We are only opposed to bounced check loans that are exorbitantly expensive, that are not accompanied by APR disclosures, that are imposed without affirmative consumer consent, or that are advertised to consumers as an easy source of credit.

Sincerely,



Rhea L. Sern

Policy Advocate

California Reinvestment Coalition

