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Regulators' Overdraft Proposal Falls Short: Fails to Protect Consumers from Unwanted Credit

May 2, 2008 -- Washington, DC— New rules on overdraft practices proposed by federal banking regulators represent a significant acknowledgment that something is wrong with the banking system in the U.S., consumer groups said. Unfortunately, the proposed rules will largely fail to protect the billions of dollars in funds stripped from American bank accounts through excessive overdraft fees every year.

Representatives from the Consumer Federation of America, Center for Responsible Lending, Consumers Union, U.S. PIRG, and the National Consumer Law Center are disappointed with new proposals issued by the Office of Thrift Supervision (OTS), the Federal Reserve Board (Fed) and the National Credit Union Administration (NCUA) concerning bank overdraft loan products. Banks now routinely allow consumers to overdraw their accounts by check, at automated teller machines or using a debit card, then charge overdraft fees.

The OTS, Fed, and NCUA proposal will require banks that allow overdrafts to provide a right to opt out of these programs, but spokespersons for the consumer groups expressed dismay that the new proposal does not require banks to obtain affirmative “opt in” before enrolling account holders in the systems.

“Bank overdraft loans are payday loans without consumer consent or a contract,” stated Jean Ann Fox, director of financial services for CFA. “Consumers should be asked for their consent first before being required to pay triple-digit interest rates for cash advances that must be repaid out of their next deposit.”

According to a recent CRL survey, consumers want—and are not getting—the choice of whether or not their checking account will include a fee-based overdraft loan feature. Respondents to the survey reported that they would overwhelmingly prefer that their debit transaction be denied at the checkout counter if approving it would cost them a \$34 fee.

The CRL survey also found that 16 percent of respondents pay 71 percent of overdraft fees. And most account holders enrolled by the bank in this most expensive of credit programs make less than \$50,000 annual income.

“The OTS and Fed proposal show that these agencies recognize that abusive overdraft loans are a significant problem,” noted Eric Halperin, DC director of the Center for Responsible Lending. “However, they would continue to allow banks to enroll customers, who never signed up for it, into the most expensive credit program the bank offers.”

The OTS and Fed proposal does make one improvement, by prohibiting overdraft fees when the overdraft is caused by a debit card “hold” by a merchant that exceeds the actual amount charged.

“We do appreciate that the regulators addressed one of the most egregious aspects of overdraft loans,” stated Edmund Mierzwinski, Consumer Program Director for USPIRG. “Prohibiting expensive fees for imaginary overdrafts is the least that the regulators could do.”

The rules ignore the issue of overdraft fees, and bounced check fees, caused by check holds due to bank's policies to delay the availability of deposited funds. Consumers Union Financial Services Campaign Manager Gail Hillebrand said: "These rules should also recognize that it is an unfair practice for a bank to charge an overdraft fee or a bounced check fee for a problem caused by the bank's decision to place a hold on the consumer's check deposit."

Overdraft loans are astronomically expensive; a \$100 overdraft with a \$34 fee has an APR of 884 percent if the overdraft lasts 2 weeks. Most are paid back more quickly. Overdraft loans made through ATM and debit cards are especially abusive, because consumers don't expect to be able to overdraw their accounts through ATM withdrawals and debit card purchases. Some banks promote their overdraft loans, encouraging consumers to overdraw their bank accounts to meet pressing financial needs. Some also charge a per day fee of \$2 to \$5 until the overdraft is repaid.

“Thirty-eight years ago, Congress stepped up to protect Americans from unwanted, unsolicited credit cards,” noted Chi Chi Wu of National Consumer Law Center. “It’s time for Congress and the regulators to do the same for overdraft loans.”

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NCLC is a non-profit organization specializing in consumer issues on behalf of low-income people. NCLC works with thousands of legal services, government and private attorneys, as well as organizations, who represent low-income and elderly individuals on consumer issues.

CFA is a nonprofit association of some 300 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

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