

Testimony of

**Nessa Feddis**

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

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Madame Chair and members of the subcommittee, my name is Nessa Feddis, and I am senior federal counsel for the American Bankers Association (ABA). I am pleased to be here today to represent the ABA on the issue of overdraft policies and practices of depository institutions and on proposals for providing customers with additional account information.

ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

American consumers enjoy the most affordable, efficient, and accessible banking system of any country in the world. Today, consumers can open a checking account with a minimal deposit and have access to the entire menu of payment services – at little or no cost. They can write checks, use debit cards to

withdraw cash or make purchases, pay bills, and make fund transfers online 24/7 from virtually anywhere in the world. For consumers, such an easy and convenient service, however, is not without important responsibilities.

In the best of all worlds, people would only write a check or make an electronic payment when there are sufficient funds in their bank accounts to cover the transaction. Of course, this isn't a perfect world. There are also many different ways for consumers to make payments today, which, while convenient for consumers, increases the challenge for them to know what payments they have made and what resources are available to them in their bank accounts to cover them.

Keeping track of transactions is critical to avoiding overdrawing an account. This is, of course, never a pleasant task and most of us would like to avoid it altogether. But doing so is part of good financial management and an important responsibility of using any transaction account. Writing transactions in your checkbook or ledger is, of course, the best way to track transactions. This is even more important today with the variety of ways that consumers can make transactions. The bottom line is that customers are in the best position to know what their actual balance is – only they know what checks they have written, automatic payments they have authorized, and debit card transactions they have approved. Simply put, consumers are in control of their finances and can avoid overdraft fees.

However, even if individuals do not keep an accurate, up-to-date record of their transactions and balance, it is easy to check the most recent balance. Customers can – and should – check their balances often by phone, at the ATM, online, or even using the Internet browser on their phone or other handheld devices. Knowing the balance – and what transactions have been authorized by the customer but have yet to be processed and are not reflected in that balance – are very important to avoid overdrafts.

Even with careful tracking, however, inadvertent overdrafts can occur. This is why banks have traditionally paid overdrafts on a discretionary basis, based on the historical activity of the account and the likelihood that the accountholder will cover the overdraft. Today's "bounce protection" or overdraft accommodation programs are basically a modern twist on this traditional practice. The primary difference is that many of the more recent overdraft protection practices rely on **automated** systems.

The advantage of the automation of the historical practice of paying overdrafts on a discretionary basis is that it reduces costs associated with case-by-case assessment and manual intervention and promotes consistent treatment of customers.

Customers who find it challenging to manage their accounts and avoid overdrafts have other options available to them. Many consumers avoid overdrafts by maintaining a cushion in the account to cover transactions they may have forgotten about or not written down in the checkbook. Others, for example, arrange for overdrafts to be covered by automatic transfers from a savings account or to a credit card account. Still others establish a line of credit to cover overdrafts. In contrast to simple overdraft accommodation provided as a courtesy by banks, these are legal agreements where the bank is obligated to pay overdrafts and customers must complete applications and be subject to the bank's underwriting standards to qualify. What works best for one customer may not work as well for another.

Madame Chair, overdraft protection is an important service for our customers and we believe customers should understand the process, the responsibilities to track deposits and withdrawals, and any fees associated with overdrafts and options to avoid them. Banks can and do provide convenient access to account information today to help customers manage their financial

flows, but ultimately it is consumers who are in the best position to track and manage their accounts.

In my testimony today, I would like to make several points:

- ***Consumers value depository institutions paying their overdrafts – and have come to expect it – as it helps to avoid the embarrassment, inconvenience, merchant fees, and other adverse consequences of having a check bounce or a transaction denied.***
- ***Consumers have many options to avoid overdraft fees.***
- ***The banking industry and regulators have been responsive to consumer concerns and will continue to work to improve overdraft protection practices.***
- ***Current technology limitations make real time notifications of overdrafts impossible and would raise the costs to merchants and consumers. Moreover, proposals that would require an APR calculation are likely only to confuse consumers and do not lead to meaningful comparisons.***

I would like to discuss each of these in turn.

### ***I. Consumers Value Depository Institutions Paying Their Overdrafts***

Ever since banks first introduced transaction accounts, the issue of how to deal with overdrafts was front and center. Obviously, the management and control of deposits and withdrawals are in the hands of the customer. While

careful tracking is the most effective way to avoid overdrafts, there will always be those times when an overdraft may inadvertently occur.<sup>1</sup>

In most cases, the customer initiating a payment transaction wants to complete it and appreciates the bank paying it, even if there are insufficient funds. It is also typically the case that even with the bank's fee, the costs of rejecting the transaction and returning the check – including the inconvenience, embarrassment, and fees charged by the merchant or payment recipient – is greater.

Today, with so many transactions taking place, overdraft protection practices are automated with specific criteria and limits on the coverage. Banks explain to customers that they *may* pay overdrafts. Usually, the amount paid is between \$100 and \$500, depending on account history, under certain circumstances. Examples of typical criteria for eligibility for the service include:

- Minimum monthly deposit;
- Periodic direct deposit;
- No delinquencies with the bank;
- Age of account;
- Average balance; and
- Maximum number of overdrafts over a certain period of time.

The advantage of the automation over the historical practice of paying overdrafts on a discretionary basis is that it reduces costs associated with case-by-case assessment manual intervention and promotes consistent treatment for all customers.

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<sup>1</sup> Knowingly making a payment without having available funds to cover it is not only a dangerous financial practice, it is illegal.

Consumers value banks' practice of paying overdrafts. Indeed, they expect it. They value the ability to avoid the embarrassment, hassle, costs and other adverse consequences of having a check bounce or transaction denied. Whether made by check or electronically, returning a payment to a merchant, mortgage company, or credit card company, usually means the consumer pays additional fees charged by the person receiving the payment. Customers also avoid the inconvenience of having to resolve the issue and arrange a second payment. They risk having adverse information reported to a credit bureau or "bad check" database. Moreover, as the consumer pays a fee whether the bank pays the item or returns it unpaid, consumers typically appreciate the depository institution paying items when there are insufficient funds.

Consumers also value having debit card transactions approved even when there are insufficient funds. For example, many consumers would rather their depository institution authorize the debit transaction than face the consequences of not being able to pay for a meal they have just consumed or the groceries that have been rung up and bagged.

Consumers understand the timing of transactions and how to manage within the overdraft accommodations provided by the bank. For example, some customers are aware of and avail themselves of the fact that even with debit card transactions, there is some window of opportunity to deposit funds *after* a transaction is made. For example, someone can make a purchase in the morning with their debit card – uncertain about their available funds at that time – and transfer or deposit money into their account before the books are closed for that day to cover the shortfall.

## **II. *Consumers Have Many Options to Avoid Overdraft Fees***

It is important to note that consumers have options to avoid overdraft fees. As discussed earlier, consumers can avoid overdrawing their accounts by

keeping track of their transactions, which banks are making easier and easier to do. Customers can check account activity and balances online or by phone. Even if they do not keep an accurate up-to-date record, customers can check their available balance just prior to a transaction by phone, at the ATM, or using the Internet browser on their handheld device.

They can also arrange to have overdrafts paid through an overdraft line of credit, credit card, or savings account. Typically, these options are less costly than overdraft fees, but customers must meet underwriting standards of the bank to qualify (which includes a credit check) or have a savings account at the bank. Many consumers avoid overdrafts by keeping a cushion of funds.

In addition, most depository institutions permit customers to opt out of having overdrafts authorized or paid. However, they usually still have to pay a bank overdraft fee as well as any merchant or payee's fee for any returned item. In addition, the option usually means that *all* nonsufficient funds transactions, not selected types of transactions, such as debit card transactions, will be returned or denied.

Depository institutions will often waive the fee for an initial or occasional overdraft. After the first incident, the consumer is then aware that debit card transactions may cause an overdraft and can take appropriate steps to avoid them. Of course, customers dissatisfied with their bank's services have many other banks to choose from in our very competitive industry.

***III. The banking industry and regulators have been responsive to consumer concerns and will continue to work to improve overdraft protection practices***

As the number of transactions – particularly using debit cards – grew and automated overdraft accommodation programs became more prevalent,

questions and concerns arose about how these accommodation programs work and how best to avoid overdraft fees.

ABA responded to these concerns in a March 21, 2003 letter sent to all ABA members from Ken Ferguson, the ABA Chairman-Elect at the time. The letter advised ABA members to exercise caution with regard to overdraft practices and offered specific suggestions. Subsequently, ABA partnered with Alex Sheshunoff Management to publish and distribute to all ABA members more extensive guidelines, the 24-page *Overdraft Protection: A Guide for Bankers*. These documents recommended that depository institutions:

- Disclose costs and terms in the agreement fully and conspicuously;
- Make clear that the depository institution is not promising to pay items;
- Avoid encouraging customers to overdraw in marketing materials, advertising, and communications;
- Monitor accounts for frequent use of the service and take appropriate actions in these situations;
- Inform customers of other ways to handle overdrafts, such as lines of credit and automatic transfers; and
- Proactively offer an opt-out giving customers a choice.

In 2005, the banking agencies adopted their *Overdraft Protection Program Guidance* (“Guidance”) that reflects many of the industry’s recommendations. The agencies’ Guidance addresses legal and safety and soundness issues and also includes best practices. Specifically, the Guidance recommends as best practices that depository institutions:

- avoid promoting overdrafts;
- fairly represent overdraft protection programs and alternatives;
- train staff to explain program features and choices;
- clearly explain discretionary nature of program;
- clearly disclose program fees;
- demonstrate when multiple fees will be charged;
- explain impact of transaction clearing policies; and
- illustrate the types of transactions covered including card transactions, preauthorized automatic debits, telephone-initiated transfers, other electronic transfers.

The Guidance offers specific best practices related to program features and operations. For example, depository institutions should:

- provide election or opt-out of service;
- alert consumers before a transaction triggers any fees where feasible, e.g., at teller window;
- prominently distinguish balances from overdraft protection funds availability;

- promptly notify consumers of overdraft protection program usage each time used;
- consider daily limits on consumers' costs;
- monitor overdraft protection program usages; and
- fairly report program usage.

One issue of concern has been repetitive use of overdraft accommodations by consumers. Banks do, as expected in the Guidance, monitor excessive use, and notify customers of other available options for managing their accounts. The Guidance also requires suspension of services when “there is a lack of timely repayment of an overdraft.” Bankers follow these practices closely, with many institutions suspending overdraft accommodation when an outstanding balance exceeds 30 days. This helps consumers who have difficulty avoiding overdrafts from getting into debt for any extended period of time.

The Federal Reserve Board went further to address concerns about consumers' understanding of the cost of overdrafts by amending Regulation DD, (Truth in Savings). Specifically, the regulation requires depository institutions that “promote” overdraft protection to disclose in periodic statements the total dollar amount of fees for paying overdrafts and the total dollar amount for fees for returning items unpaid. These totals have to be provided for the statement period and *for calendar year to date*. All depository institutions must also specify the categories of transactions for which an overdraft fee may be imposed, including, for example, ATM withdrawals and point of sale debit card transactions.

We believe that the industry's initiative along with the agencies' Guidance and important changes to Regulation DD have addressed earlier concerns about overdraft protection programs.

***IV. Current technology limitations make real time notifications of overdrafts impossible and would raise the costs to merchants and consumers. Moreover proposals that would require an APR calculations are likely only to confuse consumers and do not lead to meaningful comparisons.***

A number of suggestions have been offered addressing overdraft accommodation programs, some of which are contained in H.R. 946, the Consumer Overdraft Protection Fair Practices Act, introduced February 8, 2007 by Mrs. Maloney, (D- NY), Mr. Frank, (D-MA), and Ms. Carson, (D- IN). For example, proposals would: (1) require consumers to consent in writing to having overdrafts paid; (2) require depository institutions to calculate an APR when overdraft fees are charged; and (3) require that consumers be advised after initiating a transaction that the transaction may cause their account to be overdrawn and that they be allowed to discontinue the transaction.

**Opt-in Overdraft Accomodation.** Under the bill, banks cannot pay more than three overdrafts per year and charge a fee unless the consumer has provided specific written consent. We believe that consumers will be greatly inconvenienced and upset when their checks and electronic payments are returned unpaid and they incur additional fees from merchants and others because they forgot or were unable to notify the bank in a timely manner in writing that they wish these items to be paid. They will also be confused and unpleasantly surprised when the fourth item is returned after the first three are paid, expecting the same courtesy for the fourth item as they received for the first three. As discussed above, consumers today expect their banks to cover them

for those situations. Moreover, consumers typically pay the same fee whether the nonsufficient items are paid or returned.

**APR Calculation.** H.R. 946 appears to classify as a “finance charge” any overdraft fee beyond the first three fees paid in a year.<sup>2</sup> This means that banks would have to calculate an annual percentage rate (“APR”) for those fees, that is, those overdraft fees beyond the first three paid in a year. Given that the number, amount, and duration of overdrafts are unknowable in advance, it is not possible to incorporate them in an APR calculation. It is the consumer that determines these unknowns.

Further, even if it were possible to calculate an “historical” APR, that is, an APR calculated *after* the fact, based on the consumer’s actual behavior, it would not be helpful or meaningful to consumers. Any time an **annual** percentage rate is calculated for a term **less than a year**, the inclusion of a fixed fee, even a modest one, will distort and overstate the APR. The shorter the repayment period, the greater the APR will appear in instances where there is a fixed fee. This means that the *sooner* the consumer repays, the *greater* the calculated APR – a difficult concept to explain to consumers, as it appears that paying *earlier* actually *increases* the cost of credit.

Given the nature of overdraft fees, the APR will be greatly inflated to the point of distortion. In these cases, the fee is fixed, the overdraft often small, and the term of repayment short – the banking agencies encourage banks to request prompt repayment. It is easy to see how triple digit APRs would result. However, it is not at all clear how this would assist consumers. Rather, the inflated and distorted APR will confuse consumers as they attempt to reconcile this APR with other APRs with which they are familiar, such as the APRs for

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<sup>2</sup> “Overdraft protection fee” is defined as “any fee or charge imposed in connection with any account on which checks or other debits are paid . . . even though there are insufficient funds. . . unless such fee or charge “is imposed on an incidental basis as a customer accommodation and no more than three such overdraft fees are imposed during any calendar year.”

credit card, home, auto, and personal loans. The result will be to dilute the effectiveness of the APR generally, rather than enlighten them with regard to overdrafts. In the overdraft fee context, consumers understand a dollar amount far better than an inflated and meaningless APR.

For over forty years, the Congress and Federal Reserve Board have worked to produce a calculation that consumers can use to compare the cost of credit in a meaningful way. For the reasons given above, classifying overdraft fees as finance charges simply undermines those efforts and goals.

**Notice of Overdraft at ATMS.** Under the bill, depository institutions may not impose an “overdraft protection fee”<sup>3</sup> for electronic fund transfers “initiated at an automated teller machine” unless the depository institution has notified the consumer at the time of the transaction and before the consumer is obligated, that continuing with the transaction will result in an overdraft fee. The notice must also indicate the amount of the fee. It is not clear whether this notice is also required when a debit card is used at a point of sale terminal.<sup>4</sup>

While the proposed changes seem to impose a simple requirement, from a technical, real world perspective, it is anything but simple. The requirement would impose initial and continuing costs as well as lengthen the transaction times, especially if required for transactions made at ATMs not owned by the

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<sup>3</sup> It is not clear based on the definition of “overdraft protection fee” whether the notice is required for overdraft fees that exceed three during a single year or fees imposed by institutions that may charge more than three overdraft fees per year. “Overdraft protection fee” is defined as “any fee or charge imposed in connection with any account on which checks or other debits are paid . . . even though there are insufficient funds. . . unless such fee or charge “(A) is imposed on an incidental basis as a customer accommodation and no more than three such overdraft fees are imposed during any calendar year.”

<sup>4</sup> The bill provides that financial institutions may not impose an overdraft protection fee “in connection with any payment of an electronic fund transfer initiated by the consumer at an *automated teller machine*. . . unless the financial institution has affirmatively requested such service. . . including specific consent to allowing overdrafts at an automated teller machine *or by debit card at a point-of-sale terminal*. . .” (Emphasis added.) Strictly speaking, it appears that notice is not required at the point-of-sale terminal.

consumer's bank or point-of-sale ("POS") transactions made using debit cards. In some cases, it simply would not be feasible.

Transmitting the required notice, the amount of the fee, the customers' response, and the final authorization would necessitate prohibitive technical changes. Bandwidths used by the ATM (and POS) networks and the financial institutions would have to be increased to accommodate additional message traffic. Software would have to be developed and installed at all points in the system to allow systems to recognize and process related messages. The ATM software would have to be altered in order to provide the necessary notices. If applied to POS terminals, POS terminals and software would have to be changed or replaced in order to comply. It is not clear how depository institutions would know whether the merchants' terminals can convey the notice.

Costs would increase as the ATM and POS networks would charge the depository institution for the cost of the additional message processing.

Moreover, providing a notice and option to not continue would not be feasible in some newer applications. For example, it is possible to use "tap and go" or contactless debit cards for mass transit payments in order to reduce costs, increase customer convenience, and improve the speed of traffic flow. Application possibilities range from subways, to toll highways, to buses, to regional railroads, to taxis. Key to these applications, however, is minimal equipment and minimal processing time. The screen requirement to provide the notice would increase costs, and the time needed to provide and respond to the notice would stall traffic flow, nullifying the benefits of this application. For similar reasons, the notice requirements would make it infeasible to use debit cards at vending machines.

In sum, these requirements would not only incur immediate significant costs and create inconveniences for debit card users, but would significantly curtail new applications under development.

### ***Conclusion***

Accommodating customers when they inadvertently overdraw their accounts is a service that banks have always offered and that customers value. Careful tracking by the customer of transactions is, of course, an important responsibility. It is even more critical today than ever before, as there are many new and convenient ways to pay for the goods and services we buy. Banks are making it easier and easier to keep track of payments, making balances and transactions available by phone, online, via ATMs, and even on Internet browsers in handheld devices. Ultimately only the customer knows what checks they have written, what payments have been authorized and what debit cards have been approved.

Customers also have many options for protecting themselves against overdrafts and the associated fees – from carrying a cushion, to establishing an overdraft line of credit, to having automatic transfers from another account or to a credit card. Simply put, consumers are in control of their finances and can avoid overdraft fees altogether.

Madame Chair, the ABA appreciates the opportunity to present our views on this subject and proposals that have been suggested. We believe that overdraft accommodation services are important for our customers and we will continue to work – as we have done in the past – to make sure that customers understand the responsibilities for tracking accounts, the fees associated with overdrafts, and strategies to avoid them. I would be happy to answer questions that you or the subcommittee members might have.

Thank you.