

Testimony of Sarah Ludwig
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Before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"Overdraft Protection: Fair Practices for Consumers"
July 11, 2007

Chair Maloney, Ranking Member Gillmor, and Members of the Subcommittee, thank you for holding today's hearing, and for shining a spotlight on abusive overdraft protection, commonly referred to as "courtesy overdraft" or "bounce protection."

I am executive director of the Neighborhood Economic Development Advocacy Project (NEDAP), a resource and advocacy center based in New York City. NEDAP believes that everyone has the right to live in a decent, safe, and thriving community, and that fair access to credit and financial services is key to ensuring a community's vitality and economic inclusion for all its residents.

I am here today to tell you about NEDAP's on-the-ground experience working with low income New Yorkers who have been harmed by abusive overdraft loans. That experience is derived from NEDAP's extensive community financial education programs, as well as our NYC Financial Justice Hotline, through which we have provided legal assistance to thousands of low income New Yorkers aggrieved by discriminatory and abusive consumer finance practices. I also will share with you New York State's recent experience with respect to de-regulating bounce protection for state-chartered institutions, and underscore why it is crucial for Congress to enact legislation like H.R. 946.

I. Abusive Overdraft Protection Blurs the Line Between Mainstream and Fringe Banking

In the eleven years since NEDAP was founded, we have observed a dramatic shift in the nature and delivery of financial services in New York City, and around the country. New York City neighborhoods that were historically cut off from access to fair and affordable financial services are now flooded with solicitations for high-cost, often fringe and predatory, financial services and credit. We have all seen the advertisements: "Bad credit! No Problem!" "Need cash fast? Call us!" We now have a bifurcated system of credit in which low and moderate income Americans pay more for financial services than their middle and upper income counterparts – and typically receive financial products and services that are poorer-quality and carry few or no consumer protections.

NEDAP therefore dedicates considerable resources to educating lower income consumers on how to avoid abusive credit and asset-stripping products and services, make sound financial choices, and understand one's rights as a financial services consumer. (Included with my testimony is a sample of NEDAP's consumer education material on overdraft

loans.) It used to be a no-brainer for us to encourage people without bank accounts to obtain a bank or credit union account. But bounce protection has blurred the line between mainstream and fringe banking, and can be a financial landmine for people living on limited means. Seeing the hardship that abusive overdraft protection has caused so many of our workshop participants and clients, we are now hard-pressed to recommend categorically that people open bank accounts.

Too many people end up learning that their account has bounce protection the hard way—after they’ve overdrawn and fees have mounted. People routinely don’t know they have an overdraft protection feature on their account. They didn’t apply for it, and it’s not disclosed – as we believe it should be under the Truth in Lending Act. Many believed they they had sufficient funds in their account, because the transaction, either at the ATM or Point of Sale, went through.

Many people have told us that their accounts were closed because they could not afford to pay the hefty “bounce protection” fees, which bear no relation to the amount overdrawn or to the risk to the financial institution. When bounce protection is triggered and an account is closed, that information is reported to ChexSystems, a reporting agency that tracks and sells information on a person’s bounced checks, debts owed to a bank, and other “account mishandling.” ChexSystems functions as a sort of bank account blacklist, and NEDAP can cite numerous examples of low income New Yorkers who are now blocked from opening a bank account because of past difficulties with bounce protection. It is next to impossible for an account-holder to get a bank to remove the bounce protection feature.

II. Abusive Overdraft Protection Causes Hardship and Improperly Deprives People of Their Protected Income

David A. is a client of NEDAP who first contacted our consumer law hotline in September 2006. Mr. A is deaf and functionally illiterate. His only income is \$666 he receives in monthly Supplemental Security Income (SSI). Before his troubles with bounce protection began, he followed a regular pattern of withdrawing his money from his account. On the first day of the month, when his SSI benefits were directly deposited, Mr. A would typically withdraw several hundred dollars to pay his rent and bills. Over the next week he would make additional ATM withdrawals and pay a monthly bill for Internet service.

Mr. A opened his account with a federal savings bank in the early 1990s and had no problems until May 2005, when he unknowingly overdrew his account by \$3.44, and triggered bounce protection fees that led him into a spiral of continued overdrafts. Mr. A did not understand what was going on. Following his regular pattern of withdrawing cash and paying bills, he unknowingly continued to overdraw on the account as mounting bounce protection fees dug him deeper into debt. The bank paid each overdraft, charging \$30 for each one, including several electronic debits that amounted to less than \$8 each.

At the beginning of each month, Mr. A continued to think he had \$666 to pay his rent and cover his basic expenses. In fact, he had far less in his account, because the bank

repeatedly set off the previous month's overdrafts and fees. By November 2005, after his monthly SSI check was deposited and the bank had taken its set-off, Mr. A had only \$1.83 remaining in his account, which the bank closed for failure to maintain a positive balance.

Mr. A's account contained only his SSI benefits, income that is statutorily protected and should not have been debited from his account to set off the overdraft loan charges.

III. New York's Race to the Bottom Underscores the Need for Congressional Action

NEDAP strongly supports passage of a law like H.R. 946, which would set a strong and sorely needed federal standard. In 2005, the New York State Banking Board deregulated our state's long-standing prohibition against bounce protection, as a defensive measure to retain state-chartered banks. Then-Superintendent Diana Taylor explained the New York State Banking Department's impending deregulation:

[T]he ability of the federal banking regulators to preempt state law has increasingly meant that state regulators must choose between allowing their banks to do whatever federal regulators allow and [*sic*] national banks to do or face the prospect that banks in the state will achieve the same result by simply switching to the federally regulated or to national charter.. (Testimony of Diana Taylor, NYSBD Hearing on Proposed Overdraft Protection Regulations, Oct. 17, 2005.)

H.R. 946 would halt this race-to-the-bottom at the state level, and fill the federal regulatory vacuum we now face.

During the debate over whether the New York State should allow bounce protection, industry representatives stated that account-holders were clamoring for overdraft protection, and that banks that offered overdraft protection were simply responding to consumer demand. But they failed to distinguish between overdraft lines of credit and the abusive overdraft/bounce protection loans we're addressing today. They failed to produce any evidence to substantiate their consumer demand claim. (On the contrary, whenever we explain bounce protection in community workshops, people's immediate response is that it's an exploitative product to be avoided at all costs.) They failed to explain why, if consumers were so eager to have the product, it's tacked onto accounts without consumers' knowledge or consent. Finally, they failed to explain why, if they consumers' interests in mind, they market "free" checking accounts with bounce protection so aggressively to young people and others with low incomes whom they count on to overdraw.

NEDAP urges you to pass strong legislation to end abusive overdraft loans. Thank you for inviting me to testify today.

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ATTACHMENT - EXCERPTED FROM NEDAP'S COMMUNITY FINANCIAL LITERACY & JUSTICE CURRICULUM

WHAT YOU SHOULD KNOW ABOUT OVERDRAFT PROTECTION



What is Overdraft Protection?

"Overdraft protection" is a checking account feature offered by most banks and credit unions. With overdraft protection, the bank covers you if you do not have enough money in your account to cover a check or ATM withdrawal. Without overdraft protection, the check would "bounce" and the bank would charge you a \$20-\$40 "non-sufficient funds" (or "NSF") fee.

Overdraft protection can be a good tool to protect yourself against bounced checks. However, banks offer different types of overdraft products. Some charge huge fees and offer you few protections. Beware!

1. Overdraft Line of Credit

One way to protect yourself against bounced checks is to apply for an overdraft line of credit. If you are approved, the bank will attach a credit line of, say, \$500, to your checking account. If you withdraw cash or write a check for more than you have in your account, the bank will pay the additional amount (the "overdraft"). You pay back the overdraft with interest, usually around 18% annual percentage rate (APR).

2. BEWARE: "Courtesy Overdraft" (or "Bounce Protection")

This is a new form of overdraft protection that is causing problems for many people. First, banks automatically add this to some checking accounts, without asking you if you want it. If you withdraw cash or write a check for more than you have in your account, the bank *may or may not* pay the additional amount — it is left to the bank's discretion.

Whether or not the bank covers your overdraft, it will charge you an NSF fee of \$20 - \$40. If it covers the overdraft, the bank may also charge additional fees of \$2 - \$10 *per day until you repay the overdraft.*

Some banks include the "courtesy overdraft" amount in your account balance, making it look like you have more money than you actually do. This makes it easy to overdraw your account and trigger the high fees.

The chart below outlines the major differences between a traditional overdraft line of credit and "courtesy overdraft:"

Overdraft Line of Credit	"Courtesy Overdraft"
You must apply and meet credit-worthiness criteria.	Banks automatically add this to some accounts.
You pay back the overdraft, plus interest (usually around 18% APR).	You pay back the overdraft, plus NSF fees (usually \$20-\$40) and daily fees.
Guarantees that an overdraft will be covered—no NSF fees.	Does not guarantee that an overdraft will be covered, but charges an NSF fee regardless.
Bank must tell you the APR.	Bank is not required to tell you the APR.
If you do not pay back the overdraft, it may harm your credit report.	If you do not pay back the overdraft, it may harm your credit report.

How Do I Know if I Have "Courtesy Overdraft?"

Contact your bank to find out if your checking account has "courtesy overdraft." (Your bank may call this "overdraft privilege" or something else - but you can identify it by the high fees.) You can ask the bank to remove this, and if you like, apply for another type of overdraft protection instead.

Do I Have Other Options?

Many banks and credit unions offer other overdraft options besides those described here. For example, some have programs that cover your overdraft by transferring money from your savings account, or by billing your credit card. Make sure to ask about *all* overdraft options so you can pick the one that's best for you.

Sources: National Consumer Law Center; Consumer Federation of America.