



Statement for the Record

By the

Independent Community Bankers of America

Before the

**Congress of the United States
United States Senate
Committee on Banking, Housing, and Urban Affairs**

Hearing on

**"Protecting Consumers from Abusive Overdraft Fees: The Fairness and
Accountability in Receiving Overdraft Coverage Act"**

November 17, 2009
Washington, D.C.

Chairman Dodd, Ranking Member Shelby, Members of the Committee, the Independent Community Bankers of America¹ is pleased to submit this statement for the record on S. 1799, the Fairness in Accountability in Receiving Overdraft Coverage Act.

Approximately 76% of community banks provide some form of formal overdraft coverage, and all of those do so fairly and in a way that best meets the needs of their customers. However, community bank customers understand that when they spend money that does not belong to them, there are consequences and costs. It is this understanding that encourages community bank customers to avoid spending money they do not have, and creates the perception of overdraft services as a valued benefit of doing business with a community banker, not a predatory means of ripping someone off.

While community banks always seek to treat customers honestly, the same expectations must hold true in reverse: customers should not – and generally do not – expect a free pass when a bank covers their overdrafts. The alternatives for a consumer – merchant returned check fees, possible credit report and check verification system blemishes, collections hassle, embarrassment, and the potential reliance on payday lenders – are far worse than incurring an overdraft fee.

The issue of returned checks, and the process that occurs when a consumer writes a bad check, must be emphasized. First of all, I must note that banks are not required to honor checks drawn on insufficient funds. When a check is returned unpaid to a merchant,

¹ The Independent Community Bankers of America, the nation's voice for community banks, represents 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve.

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold \$1 trillion in assets, \$800 billion in deposits, and \$700 billion in loans to consumers, small businesses and the agricultural community.

the customer often must pick the check up and pay a fee to the store. By that point, the bad check has likely been scanned into a nationwide check verification database such as TeleCheck. When a consumer has a bad check recorded in a system like this, retailers that use check verification systems at the point-of-sale will likely not accept a check from that consumer for future purchases. Thus, any legislation that is likely to increase the amount of returned checks will unquestionably harm consumers.

ICBA strongly supports ensuring consumers are fully informed about the terms and conditions of overdraft protection programs and are made fully aware of other services for covering overdrafts that are available to them. It is also reasonable to prohibit reporting overdraft protection program usage to consumer reporting agencies when overdrafts and fees are paid according to program terms. Additionally, community bankers support the provisions in S. 1799 that restrict the advertising and marketing of overdraft products in ways that are deceptive to consumers. Overdraft protection programs are a last resort, and should not be portrayed as an extra line of credit or in any way that encourages consumers to overdraw their accounts.

Beyond those provisions, however, the legislation fails to protect community bank customers who appreciate the overdraft services their banker provides. While a one-size-fits-all legislative band-aid such as S. 1799 will have the desired effect of curbing abusive overdraft practices, it will also drastically limit the ability of fairly run overdraft programs to meet customer needs.

Legislation must exempt discretionary overdraft services

It is critical to draw a distinction among the types of overdraft services a community banker can provide. The most commonly known programs include automated

programs which are usually run by a third-party vendor that provide consumers with pre-established overdraft limits, lines of credit which require credit approval to qualify, and sweep accounts which draw overdraft coverage from a consumer's linked savings account or another checking account. Automated programs have become more common as a means of meeting consumers' evolving needs; yet these are the same programs that have understandably drawn the ire of many members of this Committee for scenarios in which a consumer overdraft results in a \$35 cup of coffee. Many community bankers tailor their automated programs so that this situation, involving a low-dollar transaction or overdraft, would never occur. Moreover, if it did occur, most community bankers would gladly refund the fees associated with such a nominal overdraft.

A final method of overdraft coverage is the discretionary coverage that a community banker provides on an individualized basis. These services are not provided through a third party, but instead involve a banker actively evaluating, on a case-by-case basis, a customer's overdraft and financial circumstances. Most often these situations arise with important, high-dollar items like a mortgage, car, or utility bill payment by check or ACH debit. As such, they are the most important expenditures faced by consumers, which would have the most harm if rejected for insufficient funds by the bank². Processing these transactions is a burdensome task for small banks, which among other things must notify the customer and make the decision on whether to pay or return the transaction. In some of these instances, overdraft situations occur just because the consumer made an error in

² The Federal Reserve, in its January 29, 2009 Final Rule on amendments to Regulation DD (the Truth in Savings Act), addressed discretionary overdraft coverage: "The Board recognized this longstanding practice when it initially adopted Regulation Z in 1969 to implement the Truth in Lending Act (TILA). The regulation provided that these transactions are generally not covered under Regulation Z where there is no written agreement between the consumer and institution to pay an overdraft and impose a fee...The treatment of overdrafts in Regulation Z was designed to facilitate depository institutions' ability to accommodate consumer's transactions on any ad hoc basis."

computing their account balance. These situations are generally corrected quickly. But, if the balance is negative for a prolonged period of time, the bank must attempt to recover the funds or suffer a loss.

Our members' practices demonstrate the strength of the relationship-driven model of community banking and how overdraft coverage can be the most personal service a banker can provide. Unfortunately, S. 1799 would jeopardize a community banker's ability to fulfill this role, leaving consumers in the lurch. ICBA urges this committee to exempt discretionary overdraft coverage from any legislation moving forward.

S. 1799 would have unintended consequences for community bank customers

ICBA strongly opposes the Fairness and Accountability in Receiving Overdraft Coverage Act. A fundamental flaw of this legislation is that it attempts to restrict the supply of overdraft coverage while discounting the fact that community bankers offer these programs to meet customer demand. Our future depends on maintaining good customer relationships by meeting their legitimate demands. It is unfortunate that S. 1799 does not focus on encouraging personal financial responsibility, and instead would dramatically burden small financial institutions who cannot afford to harm their customers with unfair or deceptive overdraft coverage.

Providing overdraft coverage is not without risk to the bank. Overdraft fees are meant to cover the real loss exposure for overdrafts a bank faces by carrying an unsecured, unpaid loan on its books. Since nothing in S. 1799 mandates that the federal government will guarantee payment to banks of any overdraft on which no fee was charged, this legislation is likely to have serious consequences for a community bank's ability to control its risk exposure. In fact, community banks have informally reported that between 15-30%

of overdraft fees must be charged off as uncollectible, and any unpaid overdraft balance must be reclassified into a loan and eventually charged off against the loan loss reserve of the bank.

Beyond this, there are numerous issues with S. 1799 that deserve careful scrutiny:

- Mandatory opt-in for all consumers on certain types of transactions is anti-consumer: Community bank customers understand and appreciate that it is in their best interest to accept a reasonable overdraft fee in exchange for their banker clearing a check or allowing a debit card point-of-sale transaction to be completed, rather than paying a non-sufficient fund fee, a bounced check fee, and facing the possibility of being late on a mortgage or other critical payment. If they do not, then they already have the means to opt-out. Additionally, while S. 1799 is consistent with recently announced Regulation E rules, it will be operationally challenging and expensive for community banks to implement overdraft policies to cover some but not all electronic transactions, as well as confusing and inconvenient for consumers.
- Price controls and quantity limits on overdrafts will reduce the availability of overdraft coverage and, potentially, other deposit services: If arbitrary caps are imposed on overdraft fees, community bankers – who are proven risk managers – must find other ways to manage the risk. These ways could include eliminating free checking for all customers, eliminating the convenience of debit cards for overdraft-prone customer, and closing overdraft-prone accounts. A likely unintended consequence of this bill would be to increase the ranks of the unbanked.

- Prohibiting banks from issuing NSF fees will not eliminate debit card overdrafts, and will result in greater losses for community banks: Debit cards pose unique risk management challenges for community banks. When a merchant obtains an authorization code from the bank, the risk does not disappear. Instead, it is transferred from the merchant to the bank, which guarantees the merchant that it will pay the transaction. While the authorization happens using the most recent balance (frequently the ledger balance from the previous night's processing) the transaction does not settle until the next day, and sometimes longer, depending on how long the merchant takes to settle their transaction. If the consumer has checks and other transactions clear in the meantime, the transaction may result in an overdraft.

One tool that community banks use to manage the risk of the point-of-sale debit guarantee is by placing a hold on the authorized amount. These holds protect the bank against funds that it has pledged to pay to the merchant, on a customer's behalf. These holds remain on the account until the transaction clears, and the bank will remove the hold if the authorization has not cleared after several days. *If an overdraft occurs while that hold is in place, the bank should not be faulted because the merchant has not settled funds and fulfilled its end of the payments process.*

- Real-time account balance information at an ATM or branch teller is not feasible. Not all banks process debits and ATM transactions in the same manner or at the same time. As a consequence, even at a bank's proprietary ATM or branch teller, the means do not exist to verify with 100% certainty that a transaction at a given moment in time will not lead to an overdraft situation should, for example, another

bank process its transactions at a later time. Additionally, banks that use a daily ledger balance rather than a real-time balance will be unable to comply with this requirement without significant financial burden.

However, ICBA appreciates the inclusion of a study to be conducted by the Government Accountability Office on the feasibility of providing an accurate means for a consumer to be informed of an overdraft situation at a point-of-sale. The system is not intended to carry this sort of information, and implementing these changes will not only carry significant cost, but will also disrupt the customer experience going forward by adding to the length of time required to complete a transaction, and also placing the customer at risk of embarrassment in the event a charge is declined. This sort of change will also require significant and costly upgrades to merchants' point-of-sale terminal equipment, another cost that likely will be passed on to merchants and ultimately to consumers.

Conclusion

In a perfect world, consumers would never find themselves in a situation where they may overdraw their account. But as this Committee is well aware, consumers do encounter situations in which overdrafts happen, be it a result of economic hardship or something as simple as a math error in computing their balance. But whatever the reason, community banks should be able to provide overdraft protection and receive a market-based, competitive fee for the cost and risk of paying transactions for a consumer with the bank's own funds.

For community banks, the consequences of this legislation are clear: if enacted, a significant portion of community banks would stop offering discretionary and automated

overdraft programs. Consumers will not appreciate the consequences of this legislation either when they face a significant increase in the amount of returned checks and rejected debit card transactions. These will not only cause embarrassment, but could affect their credit rating and cost them more money than an overdraft due to returned check charges from the merchant.

Overdraft programs are not all created equal, a fact which gives community banks the ability to leverage the unique and close relationship they have with their customers to offer them competitively priced programs to best meet their needs. This competitive advantage is an important part of what allows community banks to serve their customers, especially those who are already at the margin.

Thank you for considering our views.