WRITTEN STATEMENT

OF

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ON H.R. 3904

THE OVERDRAFT PROTECTION ACT OF 2009

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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Good morning Chairman Frank and Ranking Member Bachus. My name is Oliver Ireland. I am a partner in the financial services practice in the Washington, D.C. office of Morrison & Foerster LLP. I have over 30 years of experience in financial services issues. I also worked for the Federal Reserve System for 26 years and spent 15 years as an Associate General Counsel of the Board of Governors of the Federal Reserve System ("Board") in Washington, D.C. In my capacity at the Board, I was responsible for drafting Regulation CC, which implemented the Expedited Funds Availability Act ("EFAA") and, in doing so, substantially revamped the check return system. I was also responsible for drafting and interpreting certain Board regulations affecting deposit accounts, including the regulation governing reserve requirements, which distinguishes between savings deposits and transaction accounts based on the level of transactions, the regulation implementing the prohibition against the payment of interest on demand deposits, and was responsible for legal support of the Board's own overdraft policy, which governs overdrafts by depository institutions in their accounts at Federal Reserve Banks. I have also litigated and served as an expert witness in cases involving dishonored checks and have advised private clients in connection with the treatment of deposit account overdrafts. In addition, I was an advisor to the National Conference of Commissioners on Uniform State Laws Drafting Committee for the 1990 revisions to Articles 3 and 4 of the Uniform Commercial Code.

I am pleased to be here today to discuss H.R. 3904, the "Overdraft Protection Act of 2009." H.R. 3904 would address the practice of many depository institutions, both large and small, of charging fees for paying overdrafts due to check, automated clearinghouse and debit card transactions. While these practices have enabled consumers to meet unexpected expenses and to avoid additional costs and other consequences of failing to make timely payments when the consumers did not keep adequate track of their account balances, these practices have also been criticized as costly and unfair, particularly when imposed on small debit card transactions that consumers understood to be authorized by their depository institutions.

H.R. 3904 would amend the Truth in Lending Act to:

- require that consumers must opt in in writing before they are enrolled in overdraft coverage programs on every type of transaction;
- prohibit depository institutions from charging more than one overdraft per month and more than six overdraft fees in a single year;
- require that overdraft fees relate to the "actual cost" of processing the overdraft, as defined by bank regulators;
- prohibit charges for ATM and debit card transactions that are declined;
- regulate the order in which transactions are paid;
- require notification if a transaction at an ATM would trigger an overdraft fee and offer the consumer the chance to cancel the transaction before a fee is incurred; and
- require the GAO to study the feasibility of providing an overdraft warning notice and the opportunity to cancel the transaction for point-of-sale transactions.

In addition, as you are no doubt aware, the Board has issued a series of regulatory proposals in this area over the last few years and is currently considering a proposal to address overdrafts at ATMs and in debit card point-of-sale transactions. H.R. 3904 would go well beyond the Board's proposals by addressing overdrafts due to all types of payment transactions and by limiting fees even when a consumer chooses to receive overdraft services.

Recognizing that this Committee is likely to pass some form of H.R. 3904, and that even if the Congress does not adopt this, or similar legislation, the Board will adopt significant new requirements for overdraft programs, I will not debate the merits of these programs but rather focus on some technical aspects of H.R. 3904 and the likely effect that the adoption of the H.R. 3904, or similar requirements, would be likely to have on the pricing of transaction account services to consumers.

As an initial matter, it is not clear why the Truth in Lending Act has been chosen as the vehicle for these requirements. Applying the Truth in Lending Act to overdrafts is likely to be confusing to consumers both with respect to their rights regarding the transaction and the costs of the transaction. Under H.R. 3904, the Truth in Lending Act's billing error provisions would appear to apply whenever an overdraft coverage fee is imposed on a consumer and presumably to the transaction that resulted in the overdraft. This would mean that for checks that result in an overdraft, the consumer would have Truth in Lending billing error rights and rights under the Uniform Commercial Code, but for checks that do not result in an overdraft, only the Uniform Commercial Code would apply. Similarly, for debit card transactions, the consumer would have billing error rights under the Electronic Fund Transfer Act for transactions that do not result in an overdraft, but would have Electronic Fund Transfer and Truth in Lending billing error rights as well for transactions that result in an overdraft.

In addition, it is not clear how the Truth in Lending Act disclosure requirements would treat overdrafts. The Truth in Lending Act could be interpreted to require depository institutions to calculate an effective or historical annual percentage rate on periodic statements for overdrafts. The effective annual percentage rate has been eliminated for open-end credit because extensive consumer testing by the Board has shown that it was not an effective disclosure.

Second, H.R. 3904 applies both the choice, or opt-in, provision and the limitation on the number of overdraft fees that can be assessed to check and ACH transactions, as well as ATM and debit card transactions. At a minimum, the limitations on the number of fees that may be imposed should not apply to check and ACH debit transactions. As a practical matter, there are significant differences between these types of transactions, both in the manner in which the transactions are authorized or processed and the consequences of refusing to pay those transactions. ATM and debit card transactions are often authorized by the card issuer against a current balance in a consumer's account. Although this balance may be withdrawn before the authorized transaction settles, leading to an overdraft, a merchant accepting a debit card typically is assured of payment, and does not have to attempt to collect funds from the cardholder. In contrast, check and ACH transactions generally proceed without confirmation that good funds are on deposit to cover the transaction, leading to transactions that are disrupted after the fact by a return of the check or ACH entry.

These returns, coupled with the fact that check and ACH payments are often used for transactions that are not conducted face to face, place the payees on these transactions in the position of having to both process an often manual exception transaction, and to attempt to obtain payment for goods or services already provided from the consumer. Accordingly, merchants, utilities and other providers of goods and services that accept payment by check or ACH debit transaction typically charge significant fees to their customers for returned checks and ACH transactions. These fees, when coupled with the returned transaction fees charged by the paying institutions to cover their costs and risks from returning check and ACH transactions, lead to costs to consumers for returned transactions that significantly exceed the costs of having these transactions paid under most, if not all, overdraft payment programs. Accordingly, consumers generally benefit by paying less in fees when check and ACH transactions are paid under an overdraft program rather than returned unpaid. In addition, consumers may avoid other more costly consequences from failing to make payments on time. For example, failure to make mortgage, insurance or other bill payments on time due to a returned transaction may lead to higher costs or the inability to obtain some services. Although subject to the debit card authorization process, these additional consequences also result from the denial of preauthorized debit card transactions. Debit card use for bill payment is growing rapidly and, therefore, there is a good case for treating these transactions like check and ACH transactions and excluding them from limitations on the number of fees.

Third, H.R. 3904 would prohibit overdraft fees due to “debit holds” where a hold is placed on an account at the time that an ATM or debit card transaction is authorized and that hold exceeds the amount of the transaction that actually settles. This practice has been a particular issue with respect to pay-at-the-pump gas station transactions where the amount of the transaction can exceed the amount authorized—often only $1—by a material amount. As a practical matter, the card-issuing depository institution cannot know for sure that the amount authorized for any debit card transaction will match the amount settled until the transaction settles. Further, under the regime contemplated by H.R. 3904, in order to avoid overdrafts on ATM and debit card transactions, card issuers will have an increased incentive to place holds on ATM and debit card transactions that they have authorized in order to prevent these transactions from causing an overdraft due to intervening withdrawals or transactions.

Although there has been progress in addressing the discrepancies between amounts authorized in pay-at-the-pump transactions, most notably Visa’s real-time clearing program, if card issuers are to be prohibited from charging fees for overdrafts for transactions that exceed the authorized amount, merchants accepting debit cards should have a duty to submit the actual amount of the transaction promptly to minimize these occurrences.

Fourth, H.R. 3904 would require consumers to affirmatively choose to incur overdraft fees, limit the number of overdraft fees that can be charged per month and per year, and require that overdraft fees be reasonable and proportional to the amount of the transaction. There is substantial overlap between these provisions. For example, individual overdraft fees should be viewed as reasonable if the consumer has been notified of the amount of the fee and chosen to incur the fee. In addition, the limitation on the number of overdraft fees that may be imposed may effectively prevent the payment of overdrafts that the consumer wants to have paid because an arbitrary threshold has been reached. At a minimum, the limits on the number of fees that may be imposed should not apply to ATM transactions where the consumer elects to proceed with the transaction after being informed that the transaction will, or is likely to, result in an overdraft. Further, the requirement that fees relate to the cost of processing the transaction ignores the credit risks associated with overdraft transactions.

Fifth, H.R. 3904 would require depository institutions to post transactions in a manner that the consumer does not incur avoidable overdrafts. Under current posting procedures where some transactions are batch posted and others may be "flow" posted more or less as they occur, it is not at all clear what this standard requires. In addition, although posting contemporaneous batch processed transactions in specified order, such as high to low, may result in higher overdraft fees in some cases, it may also result in paying the larger, more important transactions first. To the extent that overall overdraft fees are limited, that limit should address the concerns that gave rise to the order of pay provision. To the extent that check and ACH overdraft fees are not limited, as I have suggested, the order of pay issue remains, but there may be no universal solution to this concern. As a practical matter, consumers' preferences for order of payment are likely to depend on the actual transactions involved and it is simply not practical to consult with consumers every time that these decisions are made.

Finally, various sources have estimated the amount of revenue that depository institutions receive from overdraft services. These numbers are high, often tens of billions of dollars per year. To the extent that H.R. 3904, or similar requirements, reduce overdraft fees and overdraft revenues to depository institutions significantly, amounts of this magnitude cannot simply be absorbed by depository institutions as an additional cost of doing business, particularly in today's troubled economy. Further, reliance on overdraft fees for revenue is not limited to large depository institutions. Overdrafts are an important source of revenue to community banks and credit unions that played no part in creating the current economic difficulties.

In order to compensate for the loss of overdraft revenue, depository institutions will be forced to reprice checking account services to consumers. Lower interest rates, more and higher account maintenance fees and per transaction fees are all likely to result from any significant limitation on overdraft fees. With interest rates at historically low levels, it is likely that checking account pricing will focus on fees that may correlate more highly with account costs rather than further reductions in interest rates paid on accounts. In addition, interest rate reductions would penalize high balance accounts that may be more profitable. On the other hand, more or higher account maintenance fees would tend to discourage consumers from maintaining small, relatively low activity accounts, possibly leading to an increase in the number of unbanked consumers. Further, per transaction fees may penalize more active accounts, thereby encouraging consumers to rely more heavily on the use of cash, which is more susceptible to loss and theft and less traceable for law enforcement purposes.

Regardless of the pricing structure that ultimately evolves, consumers will need to manage their account balances more carefully, such as by recording individual payment transactions in a register and continually updating the register to reflect not only deposits and payments, but also, potentially, the time of posting and availability of these transactions. In addition, consumers likely will need to maintain higher balances in their accounts to avoid timing errors that may result in the denial or return of a critical transaction. The need to take these steps will apply not only in the case of consumers who have not opted in, but to all consumers who may have transactions denied or returned because transactions have reached the allowable limit for overdraft fees in that month or for the year.

Thank you for the opportunity to be here today and to address this important issue. I would be happy to address any questions.