

Hearing on Consumer Protection and Middle Class Wealth Building in an Age of Growing Household Debt

Testimony before the
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Thank you Chairman Brown, Ranking Member Corker, and Members of the Subcommittee for the opportunity to submit testimony about the importance of transparent and fair financial products and services as a means to sustain and build wealth. The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life. Based on research and critical analysis, the Pew Health Group seeks to improve the health and well-being of all Americans. One important component of which is consumer financial product safety, as research by the Federal Reserve has documented the link between socioeconomic status and health.ⁱ

Pew's Safe Checking in the Electronic Age Project aims to restore transparency, fairness, responsibility and free market principles to one of the most common consumer financial products – the checking account. We appreciate this opportunity to provide further details on our consumer financial products and services research. Our findings demonstrate the importance of consumer financial protections, which allow families to manage their money responsibly and build savings and assets. Based on our

research, Pew developed policy recommendations that would bring needed transparency, fairness and free market principles to checking accounts.

Nine out of 10 Americans have a checking account, making it the most widely utilized financial services product. These accounts provide a secure way for Americans to collect earnings and make payments, and for many, they serve as the entry to the financial mainstream, where savings and credit products are available. As vehicles for millions of transactions each day, checking accounts are essential to the national economy.

In October 2010, the Pew Health Group's Safe Checking in the Electronic Age Project began a study of checking account terms and conditions to examine both the state of the marketplace and the effect of current regulations covering checking accounts.ⁱⁱ We analyzed more than 250 types of checking accounts offered online by the 10 largest banks in the United States, which held nearly 60 percent of deposit volume nationwide. Through this research, we identified a number of practices that put consumers at financial risk, potentially exposing them to high costs for little benefit. I would like to highlight three of these concerns: 1) the need for a disclosure box laying out account terms, conditions, and fees; 2) complete disclosure of all overdraft options; and 3) prohibition of transaction reordering that maximizes overdraft fees.

Clear Disclosure Makes the Market More Efficient by Allowing Comparison Shopping

Consumers need a clear, concise, and easy-to-understand disclosure of their checking account terms and conditions.

Disclosures are critical for consumers to make informed decisions, but the information needs to be presented in a format that is clear and understandable. They should convey key terms and conditions with clarity so that consumers can compare products and make purchasing decisions that best meet their needs. Clear disclosures will foster a transparent, fair, and competitive marketplace for all financial institutions by allowing them to compete for customers on a more level playing field.

Unfortunately, the checking accounts in our study did not meet this standard. We found a median of 111 pages of disclosure documents, consisting of account agreements, addenda to account agreements, fee schedules, and pages on the bank's website. The banks often used different names for the same fee or service; put the information in different documents, different media (Web or hard copy), or different locations in a document; and did not summarize or collect key information anywhere. Many of these documents are not user-friendly, with much of the text densely printed, difficult to decipher, and highly technical and legalistic. In response, we have developed a model disclosure box that could be used by financial institutions to provide relevant information to checking account customers (see below).

Pew's Model Disclosure Box for Checking Accounts

BASIC TERMS AND CONDITIONS		
Account Opening and Usage	Minimum Deposit Needed to Open Account	\$
	Monthly Fee	\$
	Requirements to Waive Monthly Fee	Minimum combined account balance, direct deposit or other conditions
	Interest Rate	%
	ATM Fees	\$ for using your bank's ATM
	ATM Fees	\$ for using another bank's ATM
	Non-Sufficient Funds (NSF) Fee	\$ per item
	Returned Check Fee	\$ per declined check written to your account
	Stop Payment Fee	\$ per item to stop payment for up to X months
	Account Closing Fee	\$ if account closed within Y days of opening
	Other Service Fees	Please consult the back of this document for a list of additional service fees.
Overdraft Options for Consumers with Debit Cards	Option A: (Default)	No Overdraft Service If you choose not to opt in to any kind of overdraft service, transactions that would cause an overdraft will be declined at no cost to you.
	Option B:	Overdraft Transfer Fee \$ per overdraft covered by transfer from linked savings account, line of credit or credit card
	Option C: Overdraft Penalty	Overdraft Penalty Fee \$ per overdraft covered by bank advance
		Maximum Number of Overdraft Penalty Fees per Day
		Extended Overdraft Penalty Fee \$ every Mth day the account is overdrawn, starting N days after the account is first overdrawn
Processing Policies	Posting Order The order in which withdrawals and deposits are processed	Summary of policy
	Deposit Hold Policy When funds deposited to your account are available	- Cash deposit with teller: X business day - Cash deposit at ATM: X business day - Check deposit with teller: Y business day - Check deposit at ATM: Y business day - Direct deposit: X business day - Wire transfer: X business day - If something causes a longer hold on a deposit, the first \$200 of that deposit will be made available either the same business day of the deposit or the next business day. - Funds from non-bank checks may take an extra business day to become available. A "business day" is a non-holiday weekday. The end of a business day varies by branch, but it is no earlier than 7 p.m.
Dispute Resolution	Dispute Resolution Agreement	Summary of agreement

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In developing the disclosure box, we tested different versions with consumers. In Philadelphia, Minneapolis, and Los Angeles, we heard from two groups of consumers who had opened a checking account within the past two years: one with parents who had assisted a young adult child and one with adults ages 21 to 35. Across all groups, participants were quite positive about the disclosure box. They described the information in the box as “comprehensive” and “clear,” and felt that a concise, easy-to-understand disclosure document would be useful and valuable when opening a checking account. Across groups, the box was seen as providing information that might help individuals avoid fees, penalties, and personal financial errors. One participant said, “It’s knowledge first of what you are doing so you don’t mess your account up.” Many thought the disclosure box would be useful if they wanted to investigate a bank and/or compare banks on the basis of fees.

As a follow-up, in July 2011, Pew commissioned a national survey of U.S. checking accountholders. We found that 78 percent of accountholders find that requiring banks to provide a one-page summary of information about checking accounts’ terms, conditions, and fees would be a positive change, while only 4 percent say this would be a negative change. Eight-six percent of Democrats, 74 percent of those who identify as independents, 73 percent of Republicans, and 69 percent of those who identify with the Tea Party say this would be a positive change.

The Truth in Savings Act (TISA) requires banks to offer a schedule of specified terms and conditions for all deposit accounts prior to account opening. Such disclosures must be available on demand to consumers so that they can “understand and compare accounts.” Similarly, the Electronic Fund Transfer Act (EFTA) requires financial institutions to disclose the terms and conditions when a consumer enrolls in electronic fund transfer services, such as an ATM or debit card.

Under the Dodd-Frank Act, the rulemaking authority of TISA and EFTA passed over to the Consumer Financial Protection Bureau (CFPB) on July 21, 2011. The CFPB has the authority and should require a one-page form that would provide accountholders with important fees and terms. This regulatory change would strengthen disclosure requirements so customers are given all important information about their accounts up front and would enable them to shop around for the products most suitable to their needs.

All Overdraft Options and Their Costs Should Be Disclosed

Consumers should receive comprehensive information about all available overdraft options including fee amount.

Currently, there are two main categories of overdraft products. Because banks use different terms for these products, Pew defines “overdraft penalty plans” as short-term advances made for a fee by the bank to cover an overdraft, the median cost of which is \$35. “Overdraft transfer plans” involve a transfer from another account or plan -- a savings account, credit card, or overdraft line of credit -- with a median cost of \$10. The vast majority of accounts provided by the banks in our study offered both types of overdraft plans.

As of August 15, 2010, new Federal Reserve rules require that financial institutions obtain customers’ affirmative consent (known as opt-in) before enrolling them in an overdraft penalty plan that covers debit card transactions at points-of-sale and ATMs. If a customer does not opt-in, any debit card transactions that overdraw the account will be denied with no fee charged.

Although Pew supports this rule, we would have preferred the Federal Reserve include a requirement that comprehensive information about all available overdraft options (including fee amount) be provided when the accountholder seeks overdraft coverage. Now that these rules have transferred to the CFPB, we believe that it should amend the Federal Reserve's rules to ensure that overdraft policy disclosures are clear and comprehensive. Consumers need to understand that they have three overdraft options and what each costs: not opting in, which is free; overdraft transfer plans, and overdraft penalty plans. They should require full disclosure of consumers' overdraft options prior to opt-in and as part of the disclosure box. We would like to see the CFPB issue a model form that would achieve more effective disclosure of overdraft options.

In Pew's focus groups we learned that of those participants who were familiar with overdraft options, some were generally well-informed about banking. However, several others had learned about overdraft options "the hard way," when they or their child had overdrawn an account and accrued one or more fees. Participants also expressed concern that banks depict overdraft policies as "protection" and as a benefit. They tended to see overdraft protection instead as a way for banks to collect a fee, usually multiple fees.

Our July survey showed support for better disclosure of overdraft options, with 83 percent of accountholders saying they wanted banks to be required to provide a summary of information about the overdraft options they offer, how the options work and a description of the fees, while only 2 percent said this would be a negative change. Ninety percent of Democrats, 78 percent of those who identify as independents, 81 percent of Republicans and 79 percent of those who identify with the Tea Party said

this would be a positive change, while only 1 percent of Democrats, 2 percent of independents, 2 percent of Republicans and 2 percent of Tea Partiers said this would be a negative change. Eighty-two percent of those who said they have a very good understanding of the terms, conditions, and fees associated with their checking account indicated this would be a positive change, while only 2 percent said this would be a negative change.

Transaction Reordering Maximizes Overdraft Fees

Policy makers should require depository institutions to post deposits and withdrawals in a fully disclosed, objective and neutral manner that does not maximize overdraft fees, such as chronological order.

Transactions (debits, deposits, and checks) presented on a given day for posting are frequently processed in an order different from that in which the activity occurred. Such reordering can greatly impact the overdraft fees incurred by consumers. Our research shows that as of October 2010, only one of the 10 banks studied, representing less than 5 percent of accounts, informed accountholders of the order in which all debits and credits are posted.

Yet at the time of the study, all banks and all accounts reserved the right to process debits presented in a given day from highest dollar amount to lowest dollar amount. By reordering transactions to pay the largest items first, the money in a checking account is more quickly depleted so that if a customer overdrafts each small transaction will result in a fee. Since that time, some banks have begun disclosing changes to their practices. Wells Fargo, Chase, and Citibank announced that they would no longer reorder certain types of transactions for at least a portion of their accounts.

Currently, there are no federal regulations that govern the order of posting among transactions processed on the same day. There is no legal requirement that banks post deposits before withdrawals, nor any law or regulation governing the order in which they post debits or credits. The Federal Deposit Insurance Corporation's overdraft guidance issued in November 2010 states that its member banks should review their checking procedures to "ensure they operate in a manner that avoids maximizing customer overdrafts and related fees through the clearing order." The Office of the Comptroller of the Currency (OCC) released a draft guidance for comment in June also inquiring about this practice.

In addition, posting orders that maximize overdraft fees, especially those that post withdrawals from largest to smallest, continue to be the subject of court challenges as an unfair and deceptive practice under state law. A federal judge in California ruled against Wells Fargo on this practice and stated in his summary of the case, "[T]he essence of this case is that Wells Fargo has devised a bookkeeping device to turn what would ordinarily be *one* overdraft into as many as *ten* overdrafts, thereby dramatically multiplying the number of fees the bank can extract from a single mistake."ⁱⁱⁱ

Opponents of this practice say it enriches the bank at the expense of consumers who receive no benefit from the reordering of their daily debits or credits. In response, banks have contended that customers prefer the largest withdrawals to be posted first because these are the most important (such as rent or mortgage payments), and therefore are the transactions that one wants to have paid first. However, by opting in to overdraft coverage, the customer has expressed the desire to have all overdrafts covered, regardless of size.

We maintain that policy makers should require depository institutions to post deposits and withdrawals in a fully disclosed, objective, and neutral manner that does not maximize overdraft fees, such as chronological order. Our July survey shows that the majority of the checking account holders agree. Seventy percent of respondents said it would be a positive change to require banks to process transactions in the order in which they occur, as opposed to processing them from highest dollar amount to lowest dollar amount, which can lead to more overdraft fees.

Hidden Bank Fees Can Drive Consumers Out of the Banking System

To encourage the working poor to build savings and credit, banks, community organizations, local leaders, and policymakers can promote policies that allow households to use their bank accounts effectively and beneficially.

This month, Pew will release a longitudinal study of 2000 low-income Los Angeles area households, 1000 with and 1000 without a bank account, which explores the connections between financial services, the populations they serve or are failing to serve, and the financial stability of those populations. We found, not surprisingly, that between 2009 and 2010, a time of great economic turmoil throughout the country, the ranks of the unbanked (those without a bank account) increased, with more families leaving banking than opening bank accounts. But what was surprising was that the most common reason these households cited for leaving banking was unexpected or unexplained fees. Nearly one in three listed these fees as the reason for leaving banking. This is particularly relevant given that even in difficult economic times only 27 percent attributed their departure from banking to job loss or lack of funds.

Our study also found that banks hold significant service and location advantages over alternative financial service (AFS) providers: 79 percent of crossover respondents (those with at least one bank account that regularly use AFS) report that banks have better customer service than check cashers and 59 percent prefer the location of banks to that of check cashers. However, these customers continue to supplement their depository accounts with services from AFS providers, citing the need to access cash quickly (30 percent) and the ability to purchase multiple services, such as money orders and remittances, at one time (38 percent).

Finally, we found that the banked could better sustain their savings behaviors, including those associated with long-term goals such as paying for college, even during economic turmoil and when faced with high rates of job loss and declining household income.

To encourage the working poor to build savings and credit, banks, community organizations, local leaders, and policymakers can promote policies that allow households to use their bank accounts effectively and beneficially. Additionally, the continued use of AFS by banked households presents an opportunity for banks to utilize their competitive advantage and capture this market for revenue-generating financial services. For example, banks can provide a comprehensive suite of products including money orders, remittances, check-cashing, bill pay services, and personal loans. Community organizations, local governments, depository institutions, along with efforts to reach the unbanked, such as the Bank On programs, can provide financial education to help new customers manage costs and build up assets. Banks, policymakers, and community organizations can capitalize on household aspirations to build family financial security by providing low-cost, easy-to-understand opportunities for savings and asset building.

Pew’s research demonstrates that bank policies and practices have a central role in allowing consumers to use and manage their money responsibly. Yet unexpected fees continue to plague consumers. For vulnerable populations, these fees can mean the difference between having a checking account and forgoing these services altogether. Providing information in a clear, concise disclosure box so that consumers can comparison shop for an account that best meets their needs will enhance competition and make the market more efficient. Practices that maximize fees, like transaction reordering, should be prohibited, since this makes it very difficult for consumers to manage their money and avoid these charges. Transactions should be processed in a predictable manner that responsible consumers can follow. Posting order should be objective and neutral rather than designed to maximize fees. These changes allow consumers to build and sustain wealth by removing much of the hidden risks currently found in checking accounts.

Thank you.

ⁱ Daly, Mary, Greg Duncan, Peggy McDonough, and David Williams. “Optimal Indicators of Socioeconomic Status for Health Research.” *American Journal of Public Health*. 2002 Jul; 92(7):1151-7.

<http://www.ncbi.nlm.nih.gov/pubmed/12084700>

ⁱⁱ Pew Health Group, “Hidden Risks: The Case for Safe and Transparent Checking Accounts,” April 2011.

http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Checking_in_the_Electronic_Age/Pew_Report_HiddenRisks.pdf

ⁱⁱⁱ Gutierrez v. Wells Fargo Bank, N.A., 730 F. Supp. 2d 1080, 1082 (N.D. Cal. 2010)