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Statement of

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concerning

The Credit Cardholders' Bill of Rights Act of 2009
and
The Consumer Overdraft Protection Fair Practices Act of 2009

before the

Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives

March 19, 2009

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Department of the Treasury

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I. Introduction

Good afternoon Chairman Gutierrez, Ranking Member Hensarling and members of the Subcommittee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on the Credit Cardholders' Bill of Rights Act of 2009 (H.R. 627), the Consumer Overdraft Protection Fair Practices Act (H.R. 1456) and issues related to credit card lending and overdraft protection. Thank you also for your interest and leadership on these important aspects of the financial services market. We share your commitment to protecting consumers from abusive practices.

I would like to take this opportunity to update the Subcommittee on OTS efforts to curb such practices. On August 6, 2007, the OTS issued an Advance Notice of Proposed Rulemaking (ANPR) that started the process of determining whether new rules to prevent unfair or deceptive acts or practices (UDAPs) should be issued.[1] The notice solicited comment on a wide range of practices that could be banned under the Federal Trade Commission (FTC) Act, including practices related to the marketing, origination, and servicing of credit cards and practices relating to overdraft protection.

Based on our review of comments from consumer advocates, industry representatives, members of Congress and the general public, we worked with the Federal Reserve Board (FRB) and National Credit Union Administration (NCUA) (collectively, the Agencies) to propose a rule in May 2008 to address unfair practices. The proposal sought comment on both credit card and overdraft protection practices that have been the subject of public debate. The final rule, issued in January 2009, is intended to provide consumers with a reasonable time to pay credit card bills,

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[1] See Unfair or Deceptive Acts or Practices: Advance Notice of Proposed Rulemaking, 72 FR 43570 (August 6, 2007).

fairly allocate payments to balances with different interest rates, establish certain restrictions on increasing interest rates, ban double-cycle billing and limit the fees charged for opening an account. As I will explain in more detail below, the final rule accomplishes the key goals of H.R. 627.

I will also address our concern about certain overdraft protection practices and summarize steps already taken to address some of these concerns. Finally, I will discuss our willingness to adopt rules in this area and our support for a related rulemaking undertaken by the FRB.

II. Development of the Final UDAP Rule

A. Robust Public Comment

The Agencies collectively received more than 66,000 comments on the May 2008 UDAP proposal, one of the largest responses to a rulemaking proposal that we have ever received. Comments were submitted from a wide range of stakeholders. These included four letters signed by 74 members of Congress, as well as 64 letters from members of state and local governments. The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) commented. In addition, we received hundreds of comments from depository institutions and other participants in the financial services industry, as well as 23 comments from trade associations. Most notably, we received written comments from tens of thousands of individual consumers and eight consumer advocacy organizations.

Virtually all comments from members of government and consumers voiced strong support for the proposal, particularly the proposed prohibition against interest rate increases on outstanding credit card balances. As the Ohio Treasurer observed in his letter, the thousands of comments from Ohio citizens show the magnitude of support for “reform” of credit card practices.

Among industry comments, common points included: (1) the cost and potential burden of implementation; (2) the possibility that some of the rules would reduce access to credit and increase its cost for consumers; and (3) the concern that labeling certain practices as “unfair or deceptive” at the federal level would prompt litigation against the industry at the state level, especially if the rules applied retroactively.

B. Policy Underlying the Final UDAP Rule

The Agencies finalized the UDAP Rule in December 2008 and published it in January 2009. To put the rule in perspective, it is necessary to understand its policy underpinnings.

First, in response to comments, the OTS worked with the other federal agencies with rulemaking authority under the FTC Act – the FRB, the NCUA and the FTC – to produce consistent interagency standards and a level playing field across the credit card industry. The final rule was issued jointly by the three federal agencies that have jurisdiction over virtually all credit card issuers.[2] Consequently, essentially all consumers who hold such cards will benefit from the rules. Issuers will experience little, if any, competitive disadvantage from compliance.

Second, the practices determined to be "unfair" were measured against well-established legal standards codified in the FTC Act.[3] Consequently, each practice was analyzed to assess:

- Whether it causes or is likely to cause substantial harm;
- Whether consumers can reasonably avoid the harm; and
- Whether the harm is outweighed by benefits to consumers or the market.[4]

Under the FTC Act, "unfairness" has a technical meaning. Congress has more latitude to ban practices of concern because the FTC Act only gives the Agencies authority to ban practices that meet the legal standards for unfairness or deception. Only the OTS has the authority to ban other practices under the Home Owners' Loan Act (HOLA).

Finally, the UDAP Rule requires the industry to change its business practices, rather than simply disclose them more effectively. This is a fundamental change from the past. Consumer research shows better disclosure does not address concerns raised by a number of these practices. In fact, testing showed that consumers simply could not understand some of the practices that the Agencies prohibited.[5] Even when consumers understood how a practice worked, they were not always able to use disclosures to make economically rational choices.[6] The results of this research contributed to the Agencies' decision to restrict certain practices, rather than merely require that they be better disclosed.

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[2] Because the FTC must use special rulemaking procedures that it has described as "cumbersome and time-consuming," see FTC testimony before House Subcommittee on Commerce, Trade and Consumer Protection of the Committee on Energy and Commerce delivered October 23, 2007, it did not join the other agencies in issuing the UDAP rule. As a result, consumers that do business with FTC-regulated entities such as state chartered credit unions will not receive the protections afforded consumers under the rule. Although these credit unions account for only a small share of the credit card market, there is no rational public policy for exempting them from the rule.

To address concerns about FTC rulemaking authority, the House of Representatives passed H.R. 3526 on December 5, 2007. One provision in that bill would allow the FTC to use the same rulemaking procedures as the other agencies use when promulgating a rule to address unfair or deceptive acts or practices. OTS supports this approach.

[3] See 15 U.S.C. § 45(n).

[4] See Unfair or Deceptive Acts or Practices (UDAP) Rule, 74 FR 5498, 5502-5504 (January 29, 2009).

[5] See, e.g., 74 FR at 5536 (testing shows that disclosure is not successful in helping consumers understand balance computation methods such as double-cycle billing).

[6] 74 FR at 5514 (testing shows that disclosure was not effective in helping consumers avoid the practice of allocating payments first to the balance with the lowest rate).

C. How the Final UDAP Rule Accomplishes Key Goals of *The Cardholders' Bill of Rights Act of 2009* (H.R. 627)

If enacted, H.R. 627 would provide consumers who hold credit cards with a number of additional protections. We share many of the concerns that prompted Congresswoman Maloney to introduce this bill and we see the benefit of many of its provisions. However, OTS sees benefit in addressing the underlying abuses through regulation. The advantage of a regulatory approach is agility. It enables agencies to respond to unfairness or deception as it emerges.

1. Unfair Time to Make Payment.

Like H.R. 627, the UDAP Rule is intended to ensure that consumers have enough time to pay their credit card bills. Under the UDAP Rule, an institution may not treat a payment as late unless the institution provides a reasonable amount of time for the consumer to make payment. The rule provides a safe harbor for an institution that sends periodic statements at least 21 days prior to the payment due date.[7] The Agencies considered this sufficient time for a statement to travel from an issuer to a consumer, for a consumer to review the bill and for payment to travel from the consumer to the issuer.

2. Unfair Increases in Annual Percentage Rates (APRs).

Like H.R. 627, the UDAP Rule is intended to address pricing practices that are harmful to consumers. These range from "any time/any reason" repricing, in which an issuer retains sole discretion to raise APRs, to "universal default," in which a consumer's APR is raised for failure to pay an unrelated account on time. In either case, a cardholder's APR is increased for reasons other than the cardholder's performance on the account.

The UDAP Rule addresses these problems by focusing on price transparency. To put it simply: no "gotchas." We have taken this tack because research shows that rate is what consumers view as the most important feature of credit cards.[8] It is what they shop for. Consequently, the UDAP Rule is intended to ensure that consumers can rely on the rates that they are promised.

To accomplish this, the UDAP Rule requires institutions to disclose at account opening all interest rates that will apply to the account. It then prohibits institutions from increasing those rates, except in the circumstances outlined below:

- Account-Opening Exception. If a rate disclosed at account opening expires after a specified period of time, institutions may apply an increased rate that was also disclosed at account opening.

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[7] H.R. 627 would require an institution to mail a periodic statement 25 days before payment is due.

[8] 74 FR at 5521.

- Variable Rate Exception. Institutions may increase a rate due to the operation of an index (in other words, the rate is a variable rate).

- Delinquency Exception. Institutions may increase a rate if the minimum payment is received more than 30 days after the due date.

- Workout Exception. If a workout arrangement does not succeed, institutions may return a consumer to the rate in effect before the workout arrangement.

After the first year, institutions may also take advantage of an additional exception. They may increase the rate applicable to new transactions after providing cardholders with the 45-day advance notice now required by Regulation Z.[9]

Although H.R. 627 addresses pricing issues in a manner that is broadly similar to the approach taken by the UDAP Rule, there are some important differences. First, H.R. 627 only prohibits issuers from increasing APRs that apply to *existing* balances. As explained above, the UDAP Rule goes further. During the first year in which an account is open, the UDAP Rule prohibits rate increases on *new* balances unless one of the exceptions applies.

Another example is how promotional rates can be repriced. Under H.R. 627, an issuer may raise a rate when a promotional rate is lost for a reason specified in the account agreement, such as paying late by even a day. Although the Agencies proposed permitting such an approach, commenters persuaded us that doing so would foster the very practices that we intended to prevent. For example, an institution might attempt to attract new customers by offering a promotional rate that is lower than its competitors' rates. In order to make this strategy profitable, such an institution might set conditions on retaining the rate that are intended to generate revenue through repricing. This type of practice distorts competition and undermines consumers' ability to evaluate the true cost of using credit.[10] The Agencies concluded that, absent a material default, a consumer should be able to rely on a rate for the period specified in advance by the institution. Therefore, the final UDAP Rule does not permit repricing of outstanding balances prior to the end of the specified period unless a consumer is more than 30 days delinquent.[11]

The treatment of deferred interest plans under the UDAP Rule also offers consumers more protection than H.R. 627. Such plans are typically marketed as being "interest free" for a specified period and are often offered to promote large purchases such as furniture or appliances. However, although interest is not charged to the account during that period, interest accrues at a specified rate. If the consumer violates the account terms, for example, pays one day late, or fails to pay the purchase balance in full before expiration of the period, the institution retroactively charges all of the interest that has accrued from the date of purchase. Consequently, many consumers fail to receive the "interest free" benefit that they are initially

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[9] See Truth in Lending; Final Rule, 74 FR 5244, 5413-14 (January 29, 2009).

[10] See 74 FR at 5525.

[11] Id.

promised. This is precisely the type of surprise increase in the cost of completed transactions that the UDAP Rule is intended to prevent.[12] Based on the comments received and our own analysis, the Agencies therefore concluded that the assessment of deferred interest is unfair.[13]

Workout arrangements represent a final area in which the UDAP Rule goes further in protecting consumers than H.R. 627. As originally proposed, the UDAP Rule would have prohibited an institution that reduced an APR pursuant to a workout arrangement from increasing the rate if the consumer failed to comply with the terms of the arrangement. However, such arrangements can provide important benefits to consumers in material default. Consequently, the Agencies adopted an exception to the prohibition against retroactive repricing that provides that when a consumer fails to comply with the terms of a workout arrangement, the institution may increase the APR to return the consumer to the rate that applied prior to the arrangement.[14] Because H.R. 627 does not contain a similar provision, it may discourage issuers from entering into workout arrangements that temporarily lower interest rates for consumers who are severely delinquent.

3. Unfair Allocation of Payments.

Like H.R. 627, the UDAP Rule is intended to respond to concern about payment allocation practices. Most notably, concern has arisen when different APRs apply to different balances on a credit card account. This may occur when different rates apply to balances associated with purchases, balance transfers and cash advances. In such situations, most issuers have allocated payments first to the balance with the lowest interest rate. This maximizes issuer returns, but is costly for consumers. Moreover, because cardholders have difficulty understanding how issuers allocate payments, it is hard for them to use their cards in a manner that minimizes their costs.[15]

H.R. 627 would respond to these concerns by requiring that issuers allocate payments on either a pro-rata basis or to the balance with the highest rate first. The Agencies agree that payment allocation practices can be abusive. Consequently, the UDAP Rule imposes the same requirement.[16]

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[12] The Agencies note, however, that the final rule does not preclude institutions from offering consumers interest-free promotional plans. Institutions may still offer 0 percent promotional rates for specified periods so long as they disclose the rate that will apply thereafter. Furthermore, an institution could offer a plan in which interest is assessed on purchases at a disclosed rate for a period of time but is waived or refunded if the principal is paid in full by the end of the period.

[13] See 74 FR at 5527.

[14] 74 FR at 5532.

[15] See ftnt. 6, above.

[16] H.R. 627 would apply to a consumer's entire payment. However, the UDAP Rule focuses on payments in excess of the required minimum. The Agencies took this approach in order to strike a balance between providing institutions flexibility to determine the minimum payment necessary to meet their business needs and ensuring that when consumers pay more than the minimum, payments are not allocated in a way that maximizes interest charges. See 74 FR at 5518. However, the Agencies clarified that institutions are free to apply the entire payment consistent with the payment allocation rule as a means of simplifying their operations. Id. and Comment 535.23-1, 74 FR at 5570.

H.R. 627 also includes special allocation rules for promotional rate balances and deferred interest rate balances. Specifically, H.R. 627 permits issuers to allocate the amount paid in excess of the required minimum to a deferred interest plan during the last two billing cycles before the deferred interest offer expires. This portion of the bill may therefore be viewed as a Congressional endorsement of such plans. However, as explained previously, the Agencies have concluded that deferred interest plans are unfair.

In addition, H.R. 627 requires issuers to allocate payments to promotional rate balances last. Although the Agencies had proposed such a requirement to ensure that consumers received the benefit of a promotional rate, we did not retain it in the final UDAP Rule. Based on our review of data submitted as part of the public comment process, the Agencies concluded that discounted promotional rates offer significant benefits to many consumers.[17] This, combined with industry comment demonstrating that finalizing this part of the proposal would likely have caused issuers to significantly reduce promotional rate offers due to lost revenue, caused the Agencies to conclude that no special rule for promotional rate balances should be applied.[18]

4. Unfair Balance Computation Methods.

Like H.R.627, the final rule prohibits institutions from calculating interest using a method referred to as "double-cycle billing." Under this method, when a consumer pays the entire account balance one month, but does not do so the following month, the institution calculates interest for the second month using the account balance for days in the previous billing cycle as well as the current cycle.[19] Not surprisingly, testing showed that consumers simply could not understand this practice.[20]

5. Unfair Financing of Fees/Deposits for the Issuance of Credit

Like H.R. 627, the UDAP Rule is designed to address credit cards with high account opening charges that erode most of the credit provided. Thus, on an account with a $400 credit limit, a consumer might have to pay $300 (plus interest charges) to obtain $100 of available credit. Such products are typically offered in the subprime market.[21] When consumers are charged security deposits and fees for issuing credit or making it available, they are harmed financially by the charges themselves and by the interest on those charges.

In response to the proposed rule, the Agencies received thousands of comments from consumers who had high-fee subprime credit cards. Many of these consumers said their credit

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17 See 74 FR 5519.

18 Id.

19 H.R. 627 includes an exception to the prohibition against double-cycle billing to facilitate the use of deferred interest rate plans. However, as explained above, the Agencies have concluded that offering deferred interest plans is unfair. As a result, we have concluded that no exception to the ban on double-cycle billing is warranted for these plans. The provisions of H.R. 627 that provide such an exception may not be necessary.

20 See ftnt. 5, above.

21 See 74 FR at 5538.

problems and limited incomes made high-fee subprime credit cards the only type of credit card they could obtain. Many of these consumers described themselves as elderly, living on limited incomes, or having serious health problems. Accordingly, because high-fee subprime credit cards are marketed to financially vulnerable consumers who generally cannot obtain credit card products with less onerous terms, the Agencies concluded that – even with improved disclosures – those consumers could not, as a general matter, reasonably avoid high upfront fees and low initial credit availability.[22]

Finally, as noted above, many subprime credit card issuers assess fees that consume 75 percent or more of the credit line at account opening. The benefit of receiving this relatively small amount of available credit does not outweigh its high cost.[23]

As a result of these findings, the UDAP Rule restricts high fee subprime credit cards in the following ways:[24]

- Institutions are prohibited from charging consumers for issuing credit if, during the first year after account opening, such charges consume the majority of the available credit;
- Institutions are prohibited from charging more than 25 percent of the credit limit during the first billing cycle; and
- Institutions must spread charges that exceed 25 percent of the credit limit over at least the next five billing cycles.[25]

Notably, although these products are often marketed as "credit repair" vehicles, data submitted by the industry showed that most consumers who use these cards become delinquent and further erode their credit scores.[26] Because the "credit repair" marketing appears unsubstantiated, the Agencies warned issuers about the risk of violating the FTC Act prohibition against deception and the OTS Advertising Rule.[27]

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22 74 FR at 5539-40.

23 74 FR at 5540.

24 74 FR at 5542 and 5569 (rule text applicable to institutions supervised by OTS).

25 H.R. 627 limits fees/deposits to 25 percent of the credit line, but does not require institutions to spread any of the fees/deposits over a series of billing cycles. Based on the comments received in response to the UDAP proposal, this strategy may not provide issuers with enough flexibility to continue offering credit cards in the subprime market. See 74 FR at 5541.

26 74 FR at 5541.

27 74 FR at 5543.

D. Implementation of the UDAP Rule.

When the Agencies proposed the UDAP Rule in May 2008, we sought comment on whether a one year implementation period was appropriate. Due to the substantial operational changes required by both the UDAP Rule and the FRB overhaul of the aspects of Regulation Z that apply to open-end credit,[28] most industry commenters urged the Agencies to allow a longer period of time.[29] Many asked for at least two years. Nevertheless, the Agencies provided issuers with 18 months to bring their operations into compliance with both rules. Both are effective on July 1, 2010.

In choosing this timeframe, the Agencies sought to ensure that compliance would not be so onerous that issuers – particularly smaller ones – would be driven out of the credit card business.[30] We also wanted to avoid forcing issuers to incur excessive expenses that would likely be passed on to consumers.[31] Even more importantly, we intended to foster an orderly compliance process that would not inconvenience or confuse consumers.

To move this process along, we strongly encouraged institutions to use their best efforts to conform to the final rule before July 1, 2010.[32] At the OTS, we have written to all of the institutions under our supervision to encourage them to comply as soon as possible.[33] OTS also organized a conference call on February 24, 2009 to answer implementation questions. More than 700 callers joined us, so we believe many institutions have already begun the compliance process.

III. Rulemaking Process Under H.R. 627

H.R. 627 anticipates that the FRB, in consultation with a broader group of agencies than those that wrote the UDAP Rule, would write new rules to implement the law. If H.R. 627 is enacted, its implementing rules would likely necessitate revisions to the UDAP Rule. Consequently, we respectfully request that H.R. 627 be amended to provide that its implementing rules be issued jointly by the Agencies. This approach would provide OTS the same rulemaking authority as the FRB. The history of the UDAP Rule demonstrates OTS's leadership in initiating the process to use the FTC Act rulemaking power to address abusive credit card practices. Simply being consulted as the FRB develops new rules that would likely require changes in the UDAP Rule would prevent the OTS from providing the kind of policy perspectives that significantly shaped the UDAP Rule and the important consumer protections it contains.

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28 See ftnt. 9, above. Pursuant to the amendments to Regulation Z, issuers will have to revise all of their communications with consumers, including their advertising, account opening materials, cardholder agreements and periodic statements.

29 See 74 FR at 5548.

30 Id.

31 Id.

32 Id.

33 See Letter to Thrift Chief Executive Officers dated December 18, 2008, available at: http://files.ots.treas.gov/25287.pdf.

IV. Accomplishing Key Goals of the *Overdraft Protection Fair Practices Act*

Overdraft protection programs have become ubiquitous.[34] If enacted, H.R. 1456 would protect consumers from a number of troubling practices associated with these programs. As with the credit card legislation discussed previously, we share many of the concerns that prompted this legislation and we see the benefit of many of its provisions.

As discussed in more detail below, we have issued Guidance on Overdraft Protection Programs (OTS Overdraft Guidance)[35] that focuses on some of these practices. To strengthen it, OTS may expand the guidance into rules.[36] Moreover, we support the FRB effort to strengthen Regulation E[37] to provide consumers with the opportunity to choose whether to participate in overdraft protection. Finally, OTS enforces Regulation DD,[38] which includes restrictions on consumer communications about overdraft protection. One advantage that regulatory approaches have over legislation is the flexibility for the agencies to address practices of concern as they emerge.

A. Transaction Clearing

Much like H.R. 1456, OTS Guidance on Overdraft Protection Programs (OTS Overdraft Guidance) states, "Do not manipulate transaction-clearing rules." The guidance goes on to explain that, "Transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees."[39] Moreover, the OTS Overdraft Guidance strongly encourages associations to clearly disclose rules for processing and clearing transactions.[40] In other words, we have asked institutions to disclose the actual processing order that they use.

B. Consumer Choice

H.R. 1456 would require that a consumer affirmatively consent – or opt in – before an institution could charge a fee for paying an overdraft.[41] Because many institutions automatically enroll consumers in their overdraft protection programs,[42] the federal financial institution

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34 See FDIC Study of Bank Overdraft Programs at p 5 (Nov. 2008) (FDIC Overdraft Study), available at: http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_FinalTOC.pdf (confirming that 89.5 percent of institutions studied have some form of overdraft protection program).

35 See 70 FR 8428 (February 18, 2005).

36 Such rules could be issued either pursuant to the HOLA, 12 U.S.C. §§ 1463(a) and 1464(a), which permits the OTS to issue comprehensive rules to govern the operations of savings associations or pursuant to the FTC Act prohibition against UDAPs.

37 Regulation E implements the Electronic Funds Transfer Act, 15 U.S.C. § 1693 et seq.

38 Regulation DD implements the Truth in Savings Act, 12 U.S.C. § 4301 et.seq.

39 See 70 FR at 8431.

40 Id.

41 Under H.R. 1456, consent is not required for the first three fees charged for paying overdrafts each year.

42 See FDIC Overdraft Study at p.5 (75.1 percent of studied institutions automatically enroll customers in automated overdraft programs).

regulatory agencies have long been concerned about the lack of consumer choice in this area. As early as 2005, all of these agencies recommended that institutions provide consumers with the opportunity to opt out of overdraft protection programs.[43] The OTS Overdraft Guidance went further by specifying that if it is not feasible for an association to notify consumers about overdraft fees in time for them to cancel certain kinds of transactions, the association should permit consumers to limit access to overdraft protection by transaction type.[44]

When the Agencies proposed the UDAP Rule in May 2008, we anticipated formalizing our opt-out guidance into a rule.[45] However, consumer testing revealed that most consumers would not choose to opt out of overdraft protection if that meant that their checks would be returned unpaid.[46] However, when asked if they would opt out if the choice was limited to opting out of overdrafts in connection with ATM withdrawals and debit card purchases, half of the participants indicated that they would consider doing so.[47]

The Agencies did not take action in the final UDAP rule on the overdraft protection opt-out provisions that we had proposed. However, the FRB proposed amendments to Regulation E that would provide consumers with the opportunity to avoid the payment of overdrafts through ATM withdrawals and one-time debits at point-of-sale (POS) terminals.[48] The FRB has solicited comment on whether consumers should be permitted to opt-out of the payment of overdrafts paid for such transactions, or whether institutions should be prevented from paying overdrafts unless consumers "opt-in."

OTS supports requiring that a consumer affirmatively consent, or opt-in, before an institution may charge a fee for paying an overdraft, particularly for electronic transactions. Among the institutions that participated in a recent FDIC study, POS and debit transactions accounted for the largest share of overdraft transactions: 41 percent.[49] Moreover, as noted above, many institutions automatically enroll their customers in overdraft protection programs. Studies have shown that this strategy uses the power of inertia and lack of attention on the part of consumers to create high participation in these programs.[50] However, half of the consumers tested in connection with the UDAP Rule said they would consider removing overdraft protection from their electronic transactions. Consumers should be given that choice up front.

The need for an opt-in is particularly acute among young adults. A recent study found that although they held only 7.6 percent of the accounts offered by the institutions participating

43 See OTS Overdraft Guidance, 70 FR at 8431 and OCC, FRB, FDIC and NCUA Joint Guidance on Overdraft Protection Programs, 70 FR 9127, 9132 (February 24, 2005).

44 See 70 FR at 8431.

45 See Unfair or Deceptive Acts or Practices; Proposed Rule, 73 FR 28904, 28929-31 (May 19, 2008).

46 See 74 FR at 5546.

47 Id.

48 See Electronic Funds Transfer; Proposed Rule, 74 FR 5212 (January 29, 2009).

49 See FDIC Overdraft Study at p.78.

50 Madrian, Brigitte C., and Shea, Dennis F., The Power of Suggestion: Inertia in 401(K) Participation and Savings Behavior, Working Paper 7682, National Bureau of Economic Research, Cambridge, MA, May 2000 (available at: http://www.nber.org/papers/w7682).

in the study, these consumers paid 61.5 percent of the overdraft fees originated at POS and debit terminals.[51] Among participating institutions, 46 percent of young adult customers had overdrafts and 25 percent had more than four overdrafts.[52] Because ATM and POS transactions are generally small – around $20.00 – the typical $27 fee often exceeds the cost of the transaction.[53]

C. Prohibition Against Misrepresentations

H.R. 1456 would prohibit institutions from misrepresenting the circumstances under which they will pay overdrafts. This prohibition would be consistent with existing OTS standards. If a savings association misrepresented these circumstances, it would likely violate the OTS Advertising Rule.[54] This rule, which is unique to OTS, prohibits a savings association from misrepresenting its services in any way. However, all of the federal financial institution regulatory agencies have previously stated that such misrepresentations should not occur, particularly when they involve the discretionary nature of many overdraft protection programs. For example, the OTS Overdraft Guidance states:

> ***Clearly explain the discretionary nature of [the] program.*** *If payment of an overdraft is discretionary, make this clear. Savings associations should not represent that the payment of overdrafts is guaranteed or assured if the savings association retains discretion not to pay an overdraft.*[55]

In fact, such a misrepresentation would violate 2005 amendments to Regulation DD. Under this rule, institutions that promote the payment of overdrafts in an advertisement must disclose in a clear and conspicuous manner the circumstances under which they will not pay overdrafts.[56] Such a misrepresentation might also be a violation of the FTC Act prohibition against deceptive practices.[57]

D. Advertising Restrictions.

When overdraft protection is offered for a fee, H.R. 1456 would prohibit the following representations in advertisements or promotions:

(1) Any representation or statement describing a transaction account as free or no cost if the account includes, or is promoted as including, overdraft protection services that involve the payment of overdraft protection fees.

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51 FDIC Overdraft Study at p.80.
52 Id.
53 Id. at p.79.
54 12 C.F.R. § 563.27.
55 See 70 FR at 8431.
56 12 C.F.R. § 230.11(b)(1)(iv).
57 15 U.S.C. § 45(a).

(2) Any representation or statement encouraging use of the account as a service to meet short-term credit needs or to obtain advances on a consumer's next payment of salary, wages, benefits, or other income.
(3) Any representation or statement that the financial institution will honor all checks or other debits presented against the account, if the institution retains discretion at any time not to honor any check or other debit presented.

Notably, the commentary to Regulation DD addresses the first point.[58] The provisions of Regulation DD discussed above address the third point. In addition, with respect to free or no cost advertising, the OTS Overdraft Guidance states:

> ***Distinguish overdraft protection services from "free" account features***. *Savings associations should not promote free accounts and overdraft protection services in the same advertisement in a manner that suggests the overdraft protection services is free of charges.*[59]

With respect to the use of the service, the OTS Overdraft Guidance states:

> ***Avoid promoting poor account management.*** *Savings associations should not market the program in a manner that encourages routine or intentional overdrafts; rather present the program as a customer service that may cover inadvertent consumer overdrafts.*[60]

Finally, as noted above, the OTS Guidance addresses representations about the discretionary nature of many programs.[61] Also as previously noted, misrepresentations about the payment discretion retained by many institutions could violate the OTS Advertising Rule and the FTC Act prohibition against deceptive practices.

V. Rulemaking Process Under H.R. 1456

H.R. 1456 directs the FRB, under authority provided in the FTC Act, to write new rules to implement the law. This approach is at odds with the existing structure of the FTC Act, which assigns the FRB authority to issue regulations that define unfair or deceptive acts or practices by banks, but provides the OTS and NCUA authority to issue comparable regulations for savings associations and federal credit unions, respectively. Consequently, we respectfully request that H.R. 1456 be amended to provide that its implementing rules be issued jointly by the Agencies. Because all depository institutions offer overdraft protection, all three agencies should have authority to write rules in this area. This approach would ensure that virtually all deposit customers receive the same protection and that virtually all depository institutions are provided with a level playing field to do business.[62] The history of the UDAP Rule demonstrates OTS's

58 12 C.F.R. part 230, Supp. I, Comment 230.8(a)-10(v) and 230.11(b)-8.
59 See 70 FR at 8431.
60 Id.
61 Id.
62 See ftnt. 2 above regarding FTC rulemaking authority.

leadership in initiating the process to use the FTC Act rulemaking power to address abusive practices. For the FRB to have sole authority to develop new rules would prevent the OTS from providing the kind of policy perspectives that significantly shaped the UDAP Rule and the important consumer protections it contains.

At the same time, OTS would respectfully note that the additional rulemaking authority contemplated by H.R. 1456 may not be necessary at all. As observed above, the FTC Act already provides the FRB, OTS and NCUA with authority to issues rules that define unfair or deceptive practices for virtually all depository institutions. This authority should be sufficient for the agencies to address the specific practices covered by H.R. 1456.

VI. Conclusion

Thank you again for the opportunity to testify, Mr. Chairman. The OTS commends your efforts to ensure that consumers are treated fairly when they use credit cards and overdraft protection programs. For our part, we are actively working to address these issues as they emerge. We have issued guidance and rules, and remain committed to employing all of our supervisory tools. We look forward to continuing to work with Congress to enhance consumer protection.