Bounce Protection: Payday Lending in Sheep's Clothing

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Payday Lending In Sheep's Clothing?

Bouncing a check is an embarrassing and expensive process. When a consumer overdrafts an account and one of their checks bounces, they incur a fee (often in the $25-$30 range) from the bank as well as a fee from the creditor to whom the check was written. In addition to this monetary consequence, the consumer will also suffer the embarrassment of having to deal with the creditor to ensure that the goods or services are ultimately either paid for or returned. This may also lead to a poor credit rating and an injured reputation in the eyes of any creditors who received a bad check.

Clearly, bouncing a check is a process that consumers prefer to avoid. But what are the alternatives when a consumer needs something before they have the funds to afford it? Consumers who qualify can get an overdraft line of credit to cover them. With an overdraft line of credit, there is a written agreement stating that the bank will cover the overdraft. Even though the interest rates for overdraft credit lines are more stable, and often have lower annual percentage rates (APRs) than bounce protection, many consumers find the interest rates too high. Furthermore, this option is only available to a limited number of consumers. Banks tend to only offer these lines of credit to people with good credit reports. The natural consequence of this

2. Id. at 34.
3. Id.
4. Id.
6. Id.
7. Id. Consultant John Floyd estimates that only 15% of consumers have check-based lines of credit. Id.
8. Id.
is that many of the people who are most in need of emergency cash wouldn’t qualify anyway.\(^9\)

Another alternative for the consumer who needs money now, but does not have the available funds, is payday lending. Payday lending is characterized by “small-dollar, short-term, unsecured lending to borrowers experiencing cash flow difficulties.”\(^10\) Consumers will “borrow against their paychecks by postdating personal checks in exchange for cash—and service charges.”\(^11\) For instance, if a consumer needs $100, they can write a check to a payday lender for $115 and then get the $100 right away.\(^12\) Two weeks later, the payday lender would then cash the $115 check.\(^13\) “Because these loans have such short terms to maturity, the cost of borrowing, expressed as an annual percentage rate (APR), can range from 300% to 1,000%, or more.”\(^14\) In states where payday lending is allowed, the related fees are often greater than what state laws allow.\(^15\)

Many banks now offer bounce protection services as a method of allowing consumers to spend money they don’t yet have.\(^16\) These services are designed to cover a consumer who overdraws an account or writes a bad check.\(^17\) When a customer overdraws an account, the banks will cover the debt and charge a fee which is usually in the amount of $20 to $30.\(^18\) Certain banks also charge a daily fee (generally $5 per day) until the consumer’s

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9. Id. Since nonsufficient funds (NSFs) go on your credit report, customers who have insufficient funds tend to have poor credit reports, and thus would fail to qualify for overdraft lines of credit. Id.
12. Id.
13. Id. Most payday lenders make the bulk of their money through rolling over loans, however. And, according to consumer groups, many consumers roll over their loans an average of seven times. The customer must then pay the fee over and over again each time the extension is made. Id.
15. Id. at 504.
16. See Cocheo, supra note 1, at 32.
18. Kline, supra note 5, at 1.
account reaches positive balance. Banks then deduct the amount covered plus fees from the customer's next deposit. Bounce protection services are distinguishable from traditional overdraft credit lines in two ways. First, bounced checks are honored at the discretion of the banks instead of a prearranged guaranteed protection as with traditional lines. Second, customers generally do not sign an agreement for bounce protection services, which are often offered as a "courtesy" by the banks.

While it provides a short-term solution for consumers who need to make a purchase now, but don't have the available funds to cover it, bounce protection exposes consumers to many of the same pitfalls as payday lending. Like payday lending, the calculated APR for bounce protection is potentially astronomical. Consider, by way of example, the customer who overdraws by $50. If the fee is $25 and he pays it back in seven days, the APR would be 2,607%. If he repays the debt in two weeks, then the APR is 1,104%, or if he repays it in 30 days, then the APR is 608%. Also, many consumers become mired in rollover fees with payday loans. Similarly, those using bounce protection incur the $30 fee every time they make a purchase until their balance is returned to zero. And with banks who charge the daily fee, consumers may rack up huge debts, presenting the

20. Id.
21. See Kline, supra note 5, at 1.
22. Thompson, supra note 17, at 4cb.
23. Consumer Federation of America/National Consumer Law Center, supra note 18.
25. Id.
26. Id.
27. Id.
28. See Wilson, supra note 11, at 341.
29. See Consumer Federation of America/National Consumer Law Center, supra note 19.
30. See Thompson, supra note 17, at 4cb.
possibility for the very same downward financial spiral as payday loans.\footnote{See Wilson, supra note 11, at 341.}

It is no surprise then, that consumer groups and other critics of bounce protection services argue that the services are predatory and in need of regulation.\footnote{See Michelle Heller, \textit{ABA's Advice: Tread Lightly,} AM. BANKER, May 20, 2003, at 4cb. In a recent memo, C. Kendrick Fergeson, the ABA’s chairman-elect, gave bank executives the following warning: “Done carefully, automated bounce protection programs can be good for your customers and for the banks. But without understanding how your program will be seen and judged in your community, in the agencies, and in court, it could become your worst nightmare. If you offer one, proceed with caution and make sure you do it right.” \textit{Id.}} Jean Ann Fox, director of consumer protection for the Consumer Federation of America (CFA), says “bounce protection is payday lending done by banks.”\footnote{Kline, supra note 5, at 1.} Even some bank consultants have indicated that bounce protection programs are the banking industry’s response to payday loans.\footnote{Consumer Federation of America/National Consumer Law Center, supra note 19.} One consultant, in an effort to convince bankers to offer bounce protection, stated that:

Some bank customers are driven by convenience and the need for short term funds. They are willing to pay for the privilege of spending money they don’t quite have yet. Somehow, these customers will get the money they need. Wary of the uncertain consequences of overdrawing their checking account, many pay routine bills late and incur late fees, many also choose to patronize payday loan outfits, cash checking services and the like. The result? Your customers are paying big fees to meet their simple banking needs, but not to you. With the OverdraftHonor program, you can give your customers an alternative, one that saves them money while dramatically increasing your fee income.\footnote{\textit{Id.} (quoting Consultant BSG).}
Bounce protection certainly has increased the fee income for banks offering the service.\textsuperscript{36} According to the Federal Deposit Insurance Corporation (FDIC), the banking industry made $30.7 billion on overdraft service charges last year, up 13% from 2001.\textsuperscript{37} One bank reported that approximately 30% of its customers have been charged bounce protection fees.\textsuperscript{38} In a recent ABA Banking Journal Community Bank Competitiveness Survey, 43.4% of banks surveyed offered fee-based overdraft plans, and 70.6% of participating banks reported that the service was a major source of revenue.\textsuperscript{39} These staggering numbers make it easy to see why many banks would offer the service. The numbers also suggest that there is clearly a consumer demand for the service.

Bounce protection serves a similar function as payday lending, operates in a similar fashion, and presents similar financial consequences for consumers.\textsuperscript{40} Yet bounce protection is not governed by the same strict TILA standards as payday lending.\textsuperscript{41} Absent a compelling reason to treat them differently, or consumer-friendly modifications made by banks, bounce protection should be governed by the same TILA guidelines that govern payday lending. This note will discuss how and why they are treated differently. It will also consider whether it is sound public policy to treat them differently and suggest modifications that could make bounce protection services safer and more useful to consumers, while limiting the potential liability that banks offering the service may face.

Part I of this note will examine the uses and abuses of bounce protection services.\textsuperscript{42} Part II of this note will discuss how bounce protection is designed to avoid regulation by TILA and Regulation Z, and potential legal limitations of the services.\textsuperscript{43} Part

\textsuperscript{36} See Thompson, \textit{supra} note 17, at 4cb.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{39} Cocheo, \textit{supra} note 1, at 32.
\textsuperscript{40} See generally Wilson, \textit{supra} note 11 (explaining the purposes, operation, and consequences of payday lending); Cocheo, \textit{supra} note 1 (explaining the purposes, operation, and consequences of bounce protection).
\textsuperscript{41} See Thompson, \textit{supra} note 17, at 4cb.
\textsuperscript{42} See \textit{infra} notes 46-79 and accompanying text.
\textsuperscript{43} See \textit{infra} notes 80-176 and accompanying text.
III will consider how to include bounce protection under TILA, and the potential ramifications of doing so. Part IV of this note will consider the ways in which banks could temper their bounce protection practices in order to offer better protection to consumers, insulate the banks from potential liability under the current law, and avoid more stringent regulation by lawmakers.

I. THE USES AND ABUSES OF BOUNCE PROTECTION SERVICES

A. Benefits of Bounce Protection

Bounce protection presents several important advantages for many consumers. The consumer can avoid paying the merchant fee and the embarrassment of bouncing a check. "What the customers love about it, is that when they give the drugstore a check, we'll pay the bank's normal overdraft fee and they don't have to be embarrassed by going back and paying another fee at the store." At the same time, banks are paying for items that consumers may need and that may otherwise be impossible for them to purchase. For instance, a consumer can pay the electric bill and know that the electricity won't be shut off due to insufficient funds. Finally, consumers who don't balance their checkbook have some form of backup to ensure that they don't have to deal with bouncing a check. "[I]f we take away the overdraft privileges or we put in so many rules and regulations, the person that suffers in the end is the consumer." Mr. Abbate argues that with so many people failing to balance their checkbook, pulling the rug out from under bounce protection

44. See infra notes 177-190 and accompanying text.
45. See infra notes 191-216 and accompanying text.
46. See Cocheo, supra note 1, at 33-34.
47. Id. at 34.
48. Thompson, supra note 17, at 4cb (quoting Charles Snipes, President of Bank of Granite).
49. See e.g. Cocheo, supra note 1, at 33.
51. Id.
plans would cause confusion and hassle for consumers and banks alike.\textsuperscript{52}

\textbf{B. The Criticisms and Abuses of Bounce Protection}

This section of this note will explore three major criticisms of bounce protection as it currently operates: 1) it entices poor consumers to use money they do not have,\textsuperscript{53} 2) many people do not ask for the service or even know that they have it,\textsuperscript{54} and 3) it lacks consumer safeguards.\textsuperscript{55}

1. Enticing Poor Consumers

A recent article by the CFA and the National Consumer Law Center (NCLC) calls bounce protection services “deliberate, systematic attempts to hook consumers onto overdrafts as a form of high cost credit.”\textsuperscript{56} Fees for overdrawing an account were originally intended to discourage consumers from spending more money than they really have, but as the service currently operates, it encourages some of them to spend more than they have.\textsuperscript{57}

One advertisement lures consumers with the temptation to “Access Your Paycheck Before You Have It!”\textsuperscript{58} By consistently honoring the checks of “chronic overdrafters,” even when the bank knows or should reasonably know that the consumer is mired in financial trouble, certain banks are preying upon their most

\textsuperscript{52} Id.
\textsuperscript{53} See Consumer Federation of America/National Consumer Law Center, \textit{supra} note 19.
\textsuperscript{54} See Kline, \textit{supra} note 5, at 1.
\textsuperscript{56} Consumer Federation of America/National Consumer Law Center, \textit{supra} note 19.
\textsuperscript{57} Thompson, \textit{supra} note 17, at 4cb (quoting Jean Ann Fox, director of consumer protection for the Consumer Federation of America).
\textsuperscript{58} Consumer Federation of America/National Consumer Law Center, \textit{supra} note 19 (citing a bounce protection advertisement found on the web site of First National Bank & Trust Company, Oklahoma).
vulnerable consumers. These same vulnerable consumers, entangled in a downward spiral of playing catch-up with all the fees, often incur the non-sufficient funds (NSF) fees over and over again. One bank consultant estimated that 80% of a bank’s overdraft income is derived from the same 15-25% of customers. Another figured that about 4% of customers were responsible for half of all NSF fees. The CFA and NCLC conclude that “this group of probably disproportionately low-to-moderate-income consumers is carrying the weight of the huge run-up in overdraft income for banks.”

Customers can easily go to the ATM and withdraw money that is in effect a loan. Similarly, debit cards will continue to work even when the customer’s funds are exhausted. Chi Chi Wu, staff attorney with the NCLC, said that this amounts to more than just a courtesy. Wu says that this makes the service essentially a short-term loan which should be subject to TILA disclosures. The fact that bounce protection extends to ATM and debit cards tends to support the claim that banks entice customers to overdraw, rather than simply coming to their aid when they write a bad check.

2. Some Consumers Are Unaware That They Have Bounce Protection

While some consumers may be enticed into using bounce protection at the ATM as a type of loan, others may overdraw at the ATM or through use of a debit card without even knowing that their own funds have expired. Some banks have set a limit of

59. Id. One bank consultant admitted that low-income individuals are more likely to use bounce protection, stating that in “areas of high unemployment, higher unemployment, you typically have more activity.” Id.
60. Id.
61. Id.
62. Id.
63. Id.
64. See Kline, supra note 5, at 1.
65. Id.
66. Thompson, supra note 17, at 4cb.
67. Id.
68. See Kline, supra note 5, at 1.
$500, up to which they will protect a consumer. However, this amount may be displayed at ATMs as part of the available account balance, encouraging some consumers to unknowingly dip into their credit line, and incur a non-sufficient funds (NSF) fee.

Customers do not sign up for the service, rather, it is designated as a “courtesy” by the bank, and customers who choose to opt out of the service must notify the bank of this decision. Because banks avoid entering into written agreements for the service (which would subject it to TILA disclosure requirements), many customers are never informed that they have bounce protection. Failure to inform consumers that they have the service undermines the congressional goal of having informed consumers with the ability to comparison shop.

3. Lack of Consumer Safeguards

In an interpretive letter, the Office of the Comptroller of the Currency (OCC) lists several aspects of bounce protection that exemplify a lack of consumer safeguards:

1) “an unlimited number of overdraft charges could be levied during a thirty day period as long as the consumer does not exceed the dollar amount limitation on overdrafts,”

2) there is “no cooling off period following repayment of overdraft charges during which no overdrafts will be paid, thus increasing the likelihood that a customer will consciously resort to use of this product to pay for ordinary day-to-day expenses,”

3) there is “no

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69. Consumer Federation of America/National Consumer Law Center, supra note 19 (citing a Cicilian Bank advertisement).
70. See id.
71. See id.
72. See id.
73. See id.
74. See 12 C.F.R. § 226.1(b) (2003). “[T]he purpose of this regulation is to promote the informed use of consumer credit by requiring disclosures about its terms and cost.” Id.
75. Stipano, supra note 55, at 6.
76. Id.
grace period (for instance, 24 hours) during which the customer can reimburse the bank without incurring the NSF charge after receiving notice that a check was paid,"77 4) banks make "no effort by banks... to identify customers who are writing overdraft checks regularly as a means of meeting regular obligations in order to attempt to serve their needs with more economical alternatives,"78 and 5) "no effort by banks offering the program to inform customers generally of available alternatives for short-term consumer borrowing, explain to customers the costs and advantages of various alternatives to the program, or identify for customers the risks and problems in relying on this product and the consequences of abuse."79

II. LEGAL LIMITATIONS ON BOUNCE PROTECTION

This section will explore the potential legal limitations on bounce protection services. First, it will examine TILA and how a court may determine that bounce protection may be governed by truth-in-lending disclosures in the same way that payday lending is, or the potential action that lawmakers may take in order to ensure that TILA governs bounce protection.80 Second, it will examine the ways that federal and state usury laws may limit bounce protection services.81 Third, it will examine how bounce protection may violate laws prohibiting unfair and deceptive trade practice.82

77. Id.
78. Id.
79. Id.
80. See infra notes 83-158 and accompanying text.
81. See infra notes 159-167 and accompanying text.
82. See infra notes 168-176 and accompanying text.
A. The Truth-in-Lending Act

The Truth in Lending Act is the piece of legislation that is most likely to limit bounce protection services. There are several elements of TILA that warrant consideration. This section will first examine the statute, along with Regulation Z. Second, it will examine the ways in which bounce protection in its current form slips through loopholes in the act, and how judges and lawmakers could reasonably find that bounce protection should be covered. Third, it will take a look at what the Consumer Advisory Council has said about the issue. Finally, it will look by way of analogy to the way that TILA governs payday loans.

1. The Statute

"[TILA] came into existence in 1968 to provide a remedy for consumers injured by lenders." Congress passed TILA to "standardize the mechanism for communicating the terms of consumer credit agreements, which in turn serves to advise borrowers of the cost of credit." TILA, as implemented by Regulation Z, reflects the intent of Congress to provide consumers with uniform cost disclosures to promote the informed use of credit and assist consumers in comparison shopping. This purpose is furthered by applying the regulation to transactions that fall within the statutory definition of credit. In order to achieve its goal of educating consumers seeking loans, TILA has strict disclosure requirements for loans. Lenders who fail to follow all

83. See Stipano, supra note 55, at 1.
84. See infra notes 88-93 and accompanying text.
85. See infra notes 94-129 and accompanying text.
86. See infra notes 130-138 and accompanying text.
87. See infra notes 139-158 and accompanying text.
88. Wilson, supra note 11, at 343.
89. Id. (quoting Charles A. Bruch, Taking the Pay out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders, 69 U. Cin. L. Rev. 1257, 1257 (2001)).
91. Id.
92. 15 U.S.C. § 1638(b); see also Wilson, supra note 11 at 344.
of the requirements subject themselves to liability for financial injuries suffered by those who take out the loans.\(^9\)

2. How Bounce Protection Slips Through TILA Loopholes

Banks offering bounce protection services naturally would prefer to avoid compliance with all of the TILA disclosure requirements, considering the unusually high APR that bounce protection services often yield.\(^9\) For this reason, bounce protection services have been carefully crafted to prevent the plans from being categorized as finance charges.\(^9\) If the plans do not qualify as finance charges, then banks will likely be free from the TILA requirements, and free from liability that may result from violations thereof.\(^9\)

One key indicator that something constitutes a “finance charge” is a guarantee of insurance or protection against an obligor's default or other credit loss.\(^9\) In response to this, banks reserve discretion whether to cover a customer's overdrawn account balance; thus, there is no guarantee that the banks will cover the consumer in the event of an overdrawn account.\(^9\)

Consumer groups note, however, that advertisements for the service consistently contradict the industry's assertions that bounce protection is “discretionary.”\(^9\) The CFA and the NCLC point to several examples of this:

Benton Bank Company states “The newest addition to our line of services is Free Checking and

\[^9\] See Wilson, supra note 11, at 344. Within the context of payday lending TILA cases, many suits have been brought as class actions, opening the door to a radical multiplier effect. Id.
\[^9\] See Renuart, supra note 24, at 13-14.
\[^9\] Thompson, supra note 17, at 4cb.
\[^9\] See Stipano, supra note 55, at 1.
\[^9\] See Consumer Federation of America/National Consumer Law Center, supra note 19. While there do not appear to be clear guidelines as to how banks exercise discretion regarding which checks to cover, each bank sets its own criteria for participation in the program. Banks generally require that a consumer have an account open for a certain time, that there are regular deposits into the account, and a lack of defaults or levies. Id.
\[^9\] Id.
Overdraft Privilege. Overdraft privilege gives you the peace of mind that your checks will be honored, up to an overdraft of $500 ($300 for Free Checking)!”\textsuperscript{100} Similarly, First Community Bank of Washington asserts that “you will know that your checks, ATM withdrawals, Visa Check Card Purchases, and other transactions will be honored up to your Bounce Protection Limit. Remember, checks drawn up to the limit will not be returned, saving you the embarrassment and expense associated with the returned check fee. This privilege can save you money.”\textsuperscript{101}

The OCC points out that many banks specify in the fine print (and often on the back of marketing materials) that they “may refuse to pay an overdraft for you” and that the service is being rendered as a “non-contractual courtesy.”\textsuperscript{102} In spite of this, many customers are confused by the apparent promises in the advertisements that the checks will be covered.\textsuperscript{103}

Another “loophole” in TILA through which banks fit bounce protection is that “charges imposed by a financial institution for paying items that overdraw an account” do not amount to finance charges “unless the payment of such items and the imposition of the charge were previously agreed upon in writing.”\textsuperscript{104} In order to exploit this exemption, banks do not have customers sign any contractual agreements in relation to this service.\textsuperscript{105}

Two federal cases from the Southern District of Mississippi illustrate the way that banks have effectively slid bounce protection services through the TILA loopholes in order to prevent recovery by plaintiffs. In \textit{Taylor v. Union Planters Bank of...}
Southern Mississippi, the plaintiffs wrote a bad check, and, in its discretion, Union Planters chose to honor it. The plaintiffs were then charged daily overdraft fees typical of some bounce protection plans upon becoming overdrawn. The plaintiffs, who were not informed about the fees prior to their accounts being charged and had never authorized the charges, brought suit alleging that TILA required the bank to disclose such fees as finance charges. At issue in the case was whether the imposition of the daily overdraft fee was covered by Regulation Z and therefore subject to TILA. The bank argued that an exception to Regulation Z applied since the service was offered as a “courtesy” and was never agreed upon in writing. The plaintiffs claimed that the Official Comments to section 226.4(b)(2) provide that such an overdraft fee is a finance charge. The court in Taylor was not convinced by the plaintiffs’ argument, and held that the “in writing” exception applied here. The same exception won the case for the defendant bank in Terrell v. Hancock Bank.

These loopholes appear to allow banks to continue this service without being subject to TILA. However, a closer examination of the relevant definitions in TILA and congressional intent in enacting TILA suggests that bounce

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107. Id. at 1121-22.
108. Id. at 1122.
109. Id.
110. Id.
112. Id. at 1123. Plaintiffs relied on Official Comment to 12 C.F.R. § 226.4(b)(2), which provides as follows: “A service charge of $5.00 per each item that triggers an overdraft credit line is a finance charge.” Id. (citing Official Comment 4(b)(2)-1 to 12 C.F.R. § 226.4). Plaintiffs argued that the daily overdraft fee is akin to the $5.00 service charge referred to in the comment “because the fee is triggered only when the bank extends credit to the consumer.” Id.
113. Id. at 1124.
114. 7 F.Supp.2d 812 (S.D. Miss. 1998).
116. See 12 C.F.R. § 226.4(a). Regulation Z defines finance charges as “the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extensions of credit.” Id.; see also 15 U.S.C. § 1605(a) (2000).
117. See 12 C.F.R. § 226.1(b).
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protection should be covered. While the court in Taylor declared that the overdraft fees were not finance charges, it neglected to say what the charges were. It is important to examine the definitions of “credit” and “finance charges” to see if they are broad enough that a court may reasonably find that TILA covers bounce protection services.

The court in Clement v. Amscot, a payday lending case, explained the definition of credit as follows: “credit is defined the same by the TILA and Regulation Z as ‘the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.’” When customers use bounce protection, they are deferring payment, and, as a result, incurring debt. This is why there is such a strong argument that it should qualify as credit.

Were it not for the exception for services not agreed upon in writing, the definition of “finance charge” would appear to accurately describe bounce protection. A “finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of the credit.” At a recent meeting of the Consumer Advisory Council, one view expressed was that:

[I]f you look just at the statute, it looks like these would be considered finance charges, which would render them credit. . . . They would be considered a finance charge and, therefore, these are credit products, because people have gotten cash. A debt

119. See Taylor, 964 F.Supp at 1124.
120. 176 F. Supp. 2d 1292 (M.D. Fla. 2001).
121. Id. at 1296 (quoting 15 U.S.C.A. § 1602(e); 12 C.F.R. § 226.2(a)(14)).
122. See Consumer Federation of America, National Consumer Law Center, supra note 19.
123. See Kline, supra note 5, at 1.
126. Id.
has been deferred, and it is due within up to 30 days by the terms of the agreements. While not in writing, because again vendors are trying to slide under the Truth in Lending radar screen, there's writing, because there's advertisements and there's written materials.¹²⁷

Given how accurately these definitions appear to describe bounce protection services, a court may be inclined to look to congressional intent despite the notable exceptions exploited by the banks. Furthermore, as a matter of public policy, judges and policy makers may hesitate to offer more protection to a bank that charges customers without their knowledge or written consent than one that clearly informs its customers of their options and services. It may be reasonable for a judge or lawmaker to consider bounce protection fees to be finance charges, and thus covered by TILA.¹²⁸ Even if bounce protection fees are not adjudicated to be finance charges, banks should be wary that the Federal Reserve Board may close these loopholes and subject bounce protection to TILA disclosures.¹²⁹

3. Where Does The Federal Reserve Board Stand?

The Federal Reserve Board is considering this issue.¹³⁰ While the usefulness of bounce protection remains unquestioned, in its current state the service is garnering considerable unwanted

¹²⁷ Renuart, supra note 24, at 5-6.
¹²⁸ Mark Pinsky, in his remarks at the Consumer Advisory Council Meeting, had this to say: “It sounds an awful lot like a credit line. . . . I can't figure out how it's not a loan. . . . [M]aybe I'm being too simplistic about it, but I just – It doesn't connect for me. I can't figure out what else you could call it.” Mark Pinsky, Remarks at the Consumer Advisory Council Meeting at the offices of the Board of Governors of the Federal Reserve System, at 22 (Mar. 13, 2003) available at www.federalreserve.gov/generalinfo/adviscoun/cac/transcripts/2003/200303/march03transcript.pdf.
¹²⁹ See Thompson, supra note 17, at 4cb. In a March 28, 2003, press release, the Fed said that “board staff is continuing to gather information on these services and will determine at a later date whether additional guidance for financial institutions is warranted under Regulation Z.” Id.
attention from the Federal Reserve Board. The Board has been soliciting comments for some time now in an attempt to determine if bounce protection should be subject to the same TILA requirements as overdraft lines.

On March 13, 2003, the Consumer Advisory Council met at the offices of the Board of Governors of the Federal Reserve System in Washington, D.C. to discuss bounce protection. The Council reached a general consensus on the importance of being honest and up front with customers. Council members also agreed that the service can be good for some consumers, but people “should not be encouraged to write NSF checks on money they don’t have.” The Council could not agree on what type of disclosures should be made to customers. Oscar Marquis summed up the proceedings:

I think where we had a disagreement was on the kind of disclosures that should be made to consumers. Should they be told – They are currently being told what the fees are. They are being told that they are paying $25 for the coverage of the NSF check or whatever the fee is. Should that be converted into an APR or not? It seems to me, that’s where the discussion – where we couldn’t really come together. Maybe the staff and the Fed can tackle that one.

131. Kline, supra note 5, at 1.
132. See Cocheo, supra note 1, at 32 (noting that over 200 comment letters have been filed thus far).
133. Kline, supra note 5, at 1.
134. See Transcript of the Consumer Advisory Council Meeting, supra note 130.
136. Id.
137. Id.
138. Id.
4. How Does TILA Handle Payday Lending?

Bounce protection has been called a “loan in sheep’s clothing, and a potential way of gouging poor people.” Consumer groups argue that bounce protection is no different than a loan and, as such, should be subject to Regulation Z’s TILA disclosures of annual percentage rates and specific credit terms. Chi Chi Wu, staff attorney with the National Consumer Law Center, points to the fact that consumers can go to the ATM and withdraw what is essentially a loan. Similarly, debit cards will continue to work even when the customer’s funds are exhausted. According to Wu, this goes beyond a “courtesy to prevent embarrassment,” and essentially amounts to a short-term loan which should be subject to TILA disclosures. Considering the similarities between bounce protection and payday lending, a strong case can be made that they should be subject to the same guidelines and requirements under TILA. In order to shed some light on how bounce protection might operate under TILA, this section will examine the similarities between bounce protection and payday lending and the way that TILA deals with payday lending.

Consumers can use either payday lending or bounce protection to get access to money when they don’t have enough in their account. Each of these practices operates in a similar fashion: pay extra fees later for the right to use money now. The effects on consumers are also similar: both payday lending and bounce protection can lead a consumer to become buried in debt,

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139. Cocheo, supra note 1, at 36 (quoting Attorney Richard Nunez, former bank compliance officer).
140. Thompson, supra note 17, at 4cb.
141. Id.
142. See Kline, supra note 5, at 1.
143. Thompson, supra note 17, at 4cb.
144. See Wilson, supra note 11, at 343.
145. Id. at 339 (explaining how consumers can use payday lending to access money); see Cocheo, supra note 1, at 34 (explaining how consumers can use bounce protection to access money).
146. Wilson, supra note 11, at 341 (explaining how payday lending operates); see Gelles, supra note 115, at E01 (explaining that a consumer may overdraw an account if they later pay a hefty fee).
while the fees keep piling up. Similar justifications are provided by the proponents of each service: it's better than the alternative of bouncing a check.

Given the strong similarities between the two practices, absent some compelling reason to the contrary, they should be subjected to the same TILA guidelines. To ascertain the potential ramifications of either finding that bounce protection should be covered by the current version of TILA, or expanding TILA to ensure that it explicitly covers bounce protection, one must examine how TILA governs payday lending.

"Courts have universally rejected the idea that payday loans should not be considered credit just because the interest charged is couched in terms of a fee." Payday lenders are indeed subject to the disclosure requirements of TILA, and case law has confirmed that lenders can be held liable for violations of TILA requirements. Further, suits for TILA violations may be brought as class actions, ensuring that plaintiffs with claims that would otherwise be too small to litigate will get their day in court. When it comes to damages for payday lending TILA violations, class action suits tend to involve statutory damages, although there is a split among the courts as to whether statutory or actual damages is the appropriate remedy.

147. Wilson, supra note 11, at 341 (explaining how payday lending may cost consumers large amounts in rollover fees); Stipano, supra note 55, at 6 (noting that there is no limit to the number of overdraft charges that may be levied in a 30 day period, so long as the consumer does not exceed the dollar amount limitation on overdrafts).

148. Wilson, supra note 11, at 342 (noting that defenders of payday lending say it is likely cheaper than bouncing a check); Cocheo, supra note 1, at 34 (noting that defenders of bounce protection say it is cheaper than bouncing a check).

149. See Wilson, supra note 11, at 343.

150. Id.

151. Id. at 344.


154. Wilson, supra note 11, at 345-47.
Courts have been clear that payday lenders will be held accountable for violations of TILA requirements. This should serve as a warning to banks offering the similar service of bounce protection. It appears that one of two things could happen rather easily: either a judge could find that bounce protection is covered by TILA, or lawmakers could amend TILA to explicitly cover bounce protection. If either one of these possibilities occur, banks who continue to offer bounce protection services would expose themselves to suits for violations of the TILA requirements, and many banks would stop offering the service altogether. It is clear that this type of activity can be regulated by TILA. The question for judges and lawmakers is whether bounce protection warrants stricter regulation, or if the positive elements of the service justify the continuing "hands-off" approach.

B. State Usury Laws

Austin L. Roberts, III, president and CEO of Bank of Lancaster, Kilmarnock, Va., refuses to offer bounce protection to his customers. He acknowledges that many bankers claim their customers love the service, but concludes that "at the end of the day it gets to be usurious." A usurious loan is one whose interest rates are determined to be in excess of those permitted by usury laws.

The elements of usury are a loan or forbearance of money, understanding that money loaned shall be returned, payment or agreement to pay rate of

155. Id. at 344.
156. This would mirror the response to payday lending issues: "the Federal Reserve Board recently added a comment to TILA's regulations that unequivocally states that payday lending is to be considered an extension of credit subject to the requirements of TILA." Wilson, supra note 11 at 343.
157. Kline, supra note 5, at 1.
158. See Wilson, supra note 11, at 343 (explaining that TILA governs payday lending).
159. Cocheo, supra note 1, at 32.
160. Id.
161. See BLACK'S LAW DICTIONARY 1543 (7th ed. 1999).
interest greater than that allowed by law, and corrupt intent to take greater return than that allowed by law for use of money loaned.\textsuperscript{162}

If bounce protection is deemed to be a loan, as urged by consumer groups,\textsuperscript{163} then the interest rates would likely exceed those permitted by states that place a limit on the amount of interest that may be charged,\textsuperscript{164} and the results could be devastating for banks. For instance, in North Carolina, a knowing violation of usury laws shall result in:

[Forfeiture of the entire interest which the note or other evidence of debt carries with it, or which has been agreed to be paid thereon. And in case a greater rate of interest has been paid, the person or his legal representatives or corporation by whom it has been paid, may recover back twice the amount of interest paid in an action in the nature of action for debt.]\textsuperscript{165}

Furthermore, each payment of usurious interest gives rise to a separate cause of action to recover penalty therefor, so that one customer may have many separate causes of action.\textsuperscript{166} Within the context of a class action suit, these damages could multiply exponentially.\textsuperscript{167}

\textsuperscript{162} See Western Auto Supply Co. v. Vick, 303 N.C. 30, 37 (1981), \textit{rehearing granted} 303 N.C. 320, \textit{on rehearing} 304 N.C. 191. "Corrupt intent" which is required for usury is intentional charging of a rate of interest which is greater than that which is allowed by law. 303 N.C. at 47. It is not necessary that the offender intended to violate usury laws. Mere intention to take interest called for in loan or forbearance agreement suffices. \textit{Id.}

\textsuperscript{163} See Thompson, \textit{supra} note 17, at 4cb.

\textsuperscript{164} See N.C. GEN. STAT. § 24-1 (2003) (providing that "the legal rate of interest shall be eight percent (8%) per annum for such time as interest may accrue, and no more").


\textsuperscript{166} See Henderson v. Security Mortg. & Fin. Co., 273 N.C. 253 (1968) (noting that such action is barred by the statute of limitations at the expiration of two years from such payment).

C. Unfair and Deceptive Trade Practices

Section 5 of the FTC Act provides: "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce are hereby declared unlawful." Bounce protection services carry with them the risk of being viewed as unfair or deceptive. A major point of criticism of bounce protection lies with the fact that consumers may not know they have the service. As a result, customers may make ATM withdrawals without knowing that they don't have the money until they receive a bill for the fees. This may trigger a violation of statutes barring "unfair and deceptive trade practices," which tend to be broad and leave room for interpretation. Most plaintiffs bring these cases under state statutes, because the FTC Act does not provide a private right of action. N.C. Gen. Stat. section 75-1.1(a) provides: "[U]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful." Plaintiffs who can show that such unfair or deceptive acts proximately caused actual injury may receive an award of damages. In addressing prohibited acts by debt collectors, the North Carolina statute provides that in private actions, civil penalties may reach up to $2,000. If bounce protection were found to be unfair or deceptive, the prospect of paying out $2,000 per violation to each plaintiff would likely cause banks to simply stop offering the service.

170. Id. at 69.
171. Id.
172. Id.
175. See N.C. Gen. Stat. § 75-56 (2003). Although in this circumstance, treble damages are not available. Id.
176. Kline, supra note 5, at 1.
III. ENVISIONING HOW TILA WOULD COVER BOUNCE PROTECTION

Unless bounce protection services are modified and consumer safeguards are added, the services should be covered by TILA.777 Closing the “in-writing” and “guarantee” loopholes in order to cover the loans requirements would cast too broad a net.178 Instead, lawmakers should do what they did to ensure that payday lending was covered: add a sentence to the TILA commentary making it explicit that bounce protection services are covered.179

In order to do so, the difficult issue of the fluctuating APRs of bounce protection must be addressed. With bounce protection, APRs fluctuate greatly depending upon the time it takes a consumer to pay off the fees.180 Some have suggested adapting the disclosure requirement for bounce protection to require disclosure of the fee, but not necessarily the APR.181 Since the goal of Congress was to inform the consumer,182 this suggestion could be a very good one. The most important thing is not necessarily that the APR is disclosed, but rather, that consumers are provided with information that allows them to understand what they are getting into.183 At the Consumer Advisory Council meeting, Clint Walker summed up this point:

You do a historical APR calculation that, you know, even though it is required by law... does not provide meaningful information to them. They see 6,000 percent APR. They go, what is happening

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177. See Thompson, supra note 17, at 4cb.
178. If there were no exceptions, then anytime someone made any type of loan to another person, the lender would be held to the rigorous disclosure standards of TILA. There is nothing to suggest that Congress intended for an individual making an informal loan to make APR disclosures, for instance. See generally 12 C.F.R. § 226.1(b).
179. Wilson, supra note 11, at 343
180. See Renuart, supra note 24, at 13.
182. See 12 C.F.R. § 226.1(b).
183. Walker, supra note 181, at 18.
here. They get confused. They make phone calls. They really haven’t gotten any information. I think the important thing to do is make sure that the fee disclosure is given up front so that they know what it is they are paying. You know, that they understand.184

There are other consequences of applying the current TILA regulations to bounce protection that lawmakers must consider. Considering all of the detailed requirements of TILA, many banks may be deterred from offering the service at all.185 It would simply present too great a risk of litigation.186 The service would no longer be available to many customers. While non-bank lenders still offer payday lending,187 bounce protection services are directly linked to a consumer’s bank account, so if the banks are scared off, then the service may cease to exist.188 To effectively eliminate a service that many consumers want to keep would not be ideal. Therefore, much of the responsibility for keeping this service falls upon the banks themselves.189 If banks change bounce protection services to better safeguard consumers, then the need for congressional intervention would be alleviated.190

IV. HOW BANKS COULD TEMPER BOUNCE PROTECTION SERVICES

Bounce protection can be a very useful service that saves customers money, hassle, and embarrassment. The majority of customers probably don’t want to forgo this service.191 Given its propensity to generate revenue, it is certain that banks do not want to stop offering the service.192 If banks wish to preserve this useful and profitable practice, they would be well advised to proactively

184. Id.
185. Kline, supra note 5, at 1.
186. See Wilson, supra note 11, at 344 (noting that TILA is so detailed as to render complete compliance difficult).
187. Id.
188. See generally Cocheo, supra note 1 (noting that bounce protection formalizes the traditional courtesy of paying insufficient checks).
189. See Feddis, supra note 118, at 40.
190. Id.
191. Id. at 38.
192. See Thompson, supra note 17, at 4cb.
self-regulate and consider modifying it. The Federal Reserve Board seems to recognize that bounce protection is a valuable service, but is concerned that as it currently operates, the service may require regulation. If banks made some consumer-friendly changes now, it might save them from potential governmental regulations or even possible legal claims. In the long run, it would make financial sense for banks to modify bounce protection in order to keep the prosperous service alive in the future.

Taking into account the many criticisms of bounce protection, it seems that banks should take action on two fronts: consumer education and consumer safeguards. Perhaps the most important improvement is to better educate consumers. If banks are confident that people like this program, then banks should let them know what it is and how it works. Banks should make clear that there are no guarantees that bad checks will be covered. To this end, advertisements of the service should avoid contradictory statements such as "The Bank will automatically pay," or "Don't worry, we've got you covered." Also, banks should not represent overdraft limits as available balance at the ATM, unless these funds are clearly tagged so that the consumer knows exactly what he or she is doing when choosing to overdraw an account. Similarly, steps should be taken to ensure that debit card users understand that just because their transaction clears at the registers, this does not necessarily mean that their account has available funds.

196. *Id.*
197. *Id.*
200. *Id.*
201. *Id.*
204. *Id.*
Banks should continue to make clear that there is a fee for this service, but try to distinguish this fee from a loan. This might be a difficult task given how similar bounce protection looks to a loan, but banks have a legitimate interest in avoiding disclosures of APR for bounce protection. Considering that bounce protection is an open-end product with potential transactions every day, it is virtually impossible to come up with an APR in the same way as in closed-end credit, and when the APR is calculated for bounce protection, it is often very high.

Banks should carefully review their advertising materials to ensure that they avoid the appearance of “enticing” customers. This is a major point of criticism from consumer groups, and if banks could avoid the perception that they are luring customers, that could go a long way in preserving bounce protection services. All advertisements are generally designed to entice consumers, so it may be difficult for banks to advertise the product without being accused of “enticing” people to use it. Still, “enticement” is an element of the service that has been uniformly criticized, and banks may do well to re-think their advertising approach.

Banks could alter the perception of enticement by educating consumers about alternatives which may make more financial sense in the individual consumer’s situation. Possible alternatives include automatic drawing into a more traditional line of credit or into a savings account when a customer overdraws a checking account.

205. Id.
207. Id.
208. Feddis, supra note 118, at 40.
209. Id.
210. See Thompson, supra note 17, at 4cb.
211. Id.
212. See Stipano, supra note 55, at 6.
While consumer education is the most important area in which banks could make changes, some of the safeguards suggested by the consumer groups may warrant consideration and could be very effective in pacifying the Federal Reserve Board. Banks ought to place some limit on the number of overdrafts a customer may incur in a given period.\textsuperscript{214} There also appears to be no mechanism by which banks attempt to identify people who are abusing bounce protection services and becoming buried in debt.\textsuperscript{215} If banks made some effort to prevent abuses of the service, they could defend themselves better against consumer criticisms and perhaps keep bounce protection services free from more stringent regulation in the future.\textsuperscript{216}

V. CONCLUSION

Bounce protection’s usefulness in certain circumstances is unquestioned,\textsuperscript{217} but lawmakers need to take a hard look to determine if there is a compelling reason to treat bounce protection any differently from payday lending. Unless bounce protection is altered to become safer for consumers, there does not appear to be sufficient justification for allowing it to remain free from TILA’s regulatory guidelines.\textsuperscript{218} Though TILA may have to adapt to adequately regulate bounce protection, unless banks can amend the services, they are in need of further regulation.\textsuperscript{219}

Banks should take reasonable steps toward keeping this moneymaker and popular consumer service intact.\textsuperscript{220} If they do so, then perhaps judges and lawmakers will continue to let the

\begin{itemize}
  \item \textsuperscript{214} See Stipano, \textit{supra} note 55, at 6. While there is a limit on the total overdraft amount for which the banks will cover customers, there is no limit on the number of overdrafts. See \textit{id}. If a given individual, either intentionally or by mistake, were to use an overdrawn debit card to buy lunch every day for a week, he would incur approximately $200 in fees (assuming that the fee is $25-$30 per overdraft). See \textit{id}.
  \item \textsuperscript{215} See \textit{id}.
  \item \textsuperscript{216} See Feddis, \textit{supra} note 118, at 40.
  \item \textsuperscript{217} See Cocheo, \textit{supra} note 1, at 33-34.
  \item \textsuperscript{218} See generally Feddis, \textit{supra} note 118 (noting the usefulness of bounce protection and suggesting consumer-friendly changes to the service).
  \item \textsuperscript{219} Id.
  \item \textsuperscript{220} Id.
\end{itemize}
thriving service continue without further regulation.\textsuperscript{221} In modifying the services, bank executives should consider the advice of C. Kendrick Fergeson, who warned that “before you offer a bounce protection product, decide if you’d want to defend the one you’re considering in your local newspaper or to your regulator.”\textsuperscript{222}

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\textsuperscript{221} Id.
\textsuperscript{222} Heller, supra note 32, at 4eb.