



STATEMENT

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“H.R. 627, THE CREDIT CARDHOLDERS’ BILL OF RIGHTS ACT OF 2009;  
AND  
H.R. 1456, THE CONSUMER OVERDRAFT PROTECTION FAIR PRACTICES ACT OF  
2009”

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT  
COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

MARCH 19, 2009

## **I. Introduction**

The National Credit Union Administration's (NCUA) primary mission is to ensure the safety and soundness of federally insured credit unions, as well as their compliance with applicable federal regulations. It performs this function by examining all federal credit unions (FCUs), participating in the supervision of federally insured, state-chartered credit unions (FISCUs) in coordination with state regulators, and insuring credit union member accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund (NCUSIF), the NCUA provides oversight and supervision to 7,806 federally insured credit unions, representing 98 percent of all credit unions and approximately 88 million members.<sup>1</sup>

The NCUA regulates and insures all FCUs and insures most state-chartered credit unions. Under this framework, the NCUA is responsible for enforcing regulations in FCUs and evaluating safety and soundness in all federally insured credit unions. The NCUA is also responsible for monitoring and ensuring compliance with most federal consumer laws and regulations in FCUs. In federally insured, state-chartered credit unions, the appropriate state supervisory authority has regulatory oversight and enforces state consumer laws and regulations.

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<sup>1</sup> Approximately 162 state-chartered credit unions are privately insured.

## II. Summary of Legislation

*Credit Card Bill.* The Credit Cardholders' Bill of Rights Act of 2009 would amend the Truth in Lending Act (TILA) to prohibit or restrict certain practices regarding open-end consumer credit.<sup>2</sup> This comprehensive credit card reform legislation is aimed at protecting consumers and abolishing industry abuses that have been described as “unfair,” “deceptive,” and “anti-competitive.” Specifically, the bill would:

- Protect cardholders against arbitrary interest rate increases;
- Prevent cardholders who pay on time from being unfairly penalized;
- Protect cardholders from unauthorized due date changes;
- Shield cardholders from misleading terms;
- Empower credit cardholders to set limits on their credit;
- Require card issuers to fairly credit and allocate payments;
- Prohibit card issuers from imposing excessive fees on cardholders;
- Prevent card issuers from giving subprime credit cards to consumers who cannot afford them; and,
- Provide for better oversight of the credit card industry.

*Overdraft Protection Bill.* The Consumer Overdraft Protection Fair Practices Act would extend the protections of TILA to overdraft protection programs and services provided by financial institutions.<sup>3</sup> Specifically, the overdraft bill would require consumers to opt-

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<sup>2</sup> H.R. 627, 111th Cong. (2009).

<sup>3</sup> H.R. 1456, 111th Cong. (2009).

in to overdraft protection programs, would require financial institutions to provide enhanced disclosures, and would prohibit financial institutions from manipulating the posting of checks and other debits to generate overdraft fees.

### **III. Credit Card Programs**

In December 2008, the NCUA, the Office of Thrift Supervision (OTS), and the Board of Governors of the Federal Reserve System (FRB; collectively, the Agencies) jointly issued the Unfair or Deceptive Acts or Practices (UDAP) rule amending each agency's credit practices rule to prohibit certain credit card practices.<sup>4</sup> Specifically, the UDAP rule addresses the following credit card practices:

- The amount of time card issuers give cardholders to make payments must be reasonable. The rule provides a safe harbor for financial institutions that send periodic statements at least 21 days before the payment due date.
- The financing of security deposits and fees for credit availability is prohibited if the charges assessed during the first 12 months will exceed 50 percent of the initial credit limit and is limited to 25 percent of the initial limit at account opening. Any additional amounts greater than 25 percent but less than 50 percent may be spread evenly over at least the next five billing cycles.
- The amount of cardholder payments exceeding the minimum payment must be allocated first to the portion of the outstanding balance with the highest annual percentage rate (APR) or pro rata among the portions of the outstanding balance with varying APRs.

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<sup>4</sup> 74 Fed. Reg. 5498 (January 29, 2009).

- The practice of calculating interest on an account balance using days in a previous and the current billing cycles, often referred to as “two-cycle” or “double-cycle” billing, is prohibited, except when adjustments to an account balance are required for a returned payment or resolution of a dispute.
- The application of increased interest rates to pre-existing balances is prohibited, except when a temporary rate and the subsequent rate at expiration are disclosed at account opening; the rate is based on a public index; the financial institution, after the first anniversary of the account, provides the cardholder notice 45 days before the higher rate becomes effective; and, the minimum payment is received more than 30 days after the due date.

Several factors prompted the issuance of the UDAP rule, including congressional inquiries directed to the Agencies, proposed amendments to the FRB’s Regulation Z<sup>5</sup> in June 2007, and an OTS advance notice of proposed rulemaking in August 2007.<sup>6</sup> Based on comments received in response to the rulemakings, the Agencies determined a broader, more comprehensive approach, addressing more than just TILA disclosures, was appropriate. Because each of the Agencies oversees financial institutions that engage in the same types of business, however, the NCUA Board determined a uniform approach to the topic was important.

The UDAP rule was issued in accordance with section 18(f) of the Federal Trade Commission Act (FTC Act), which makes the Agencies responsible for prescribing

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<sup>5</sup> 72 Fed. Reg. 32948 (June 14, 2007) (proposing amendments to 12 C.F.R. part 226).

<sup>6</sup> 72 Fed. Reg. 43570 (August 6, 2007) (requesting comments on 12 C.F.R. part 535).

regulations that prevent unfair or deceptive acts or practices in or affecting commerce within the meaning of section 5(a) of the FTC Act.<sup>7</sup> The rule amended the NCUA's credit practices rule, which is codified at 12 C.F.R. part 706 and applies to FCUs only.<sup>8</sup>

*Legal Standards for Unfairness and Deception.* Under section 5 of the FTC Act, an act or practice can be declared unfair if: (1) it causes or is likely to cause substantial injury to consumers; (2) the injury is not reasonably avoidable by consumers themselves; and (3) the injury is not outweighed by countervailing benefits to consumers or to competition.<sup>9</sup> An act or practice is deceptive if: (1) there is a representation or omission of information that is likely to mislead consumers acting reasonably under the circumstances; and (2) that information is material.<sup>10</sup> The Agencies applied these standards in determining which practices to regulate.

*Credit Card Statistics and Trends.* The percentage of federally insured credit unions offering credit card services has remained constant at about 51 percent over the last several years. The total number of federally insured credit union credit card accounts has also remained relatively constant at approximately 12 million accounts.

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<sup>7</sup> 15 U.S.C. 45(a), 57a(f)(1).

<sup>8</sup> Under the FTC Act, the NCUA does not have regulatory or enforcement authority for state-chartered credit unions. See 15 U.S.C 57a(f).

<sup>9</sup> 12 U.S.C. 45(n).

<sup>10</sup> FTC Policy Statement on Deception (October 14, 1983).

<b>Credit Card Services</b>		
<b>Date</b>	<b>Percentage Of Federally Insured Credit Unions With Card Services</b>	<b>Number of Credit Card Accounts</b>
12/31/2004	50.67%	12,240,573
12/31/2005	50.59%	12,101,618
12/31/2006	50.64%	12,110,246
12/31/2007	50.29%	12,442,704
12/31/2008	50.93%	12,609,099

The following Loan Growth table reveals that both total outstanding credit card debt and total loans grew in 2008, albeit at slower rates than in previous years. However, this growth, at a time when consumers are finding it more difficult to obtain credit from other sources, demonstrates that credit unions continue to strive to meet their member credit needs.

<b>Annual Loan Growth Rate</b>		
<b>Yearend</b>	<b>Total Credit Card Loans</b>	<b>Total Loans</b>
12/31/2005	6.29%	10.72%
12/31/2006	11.22%	8.09%
12/31/2007	13.43%	6.67%
12/31/2008	7.66%	6.40%

As disclosed in the Credit Card Delinquency Trends table below, total outstanding credit card debt in relation to total outstanding loans has been historically low and, as of yearend 2008, was at 5.8 percent. Though delinquent credit card debt to total loans is relatively low, credit card delinquency rates have been increasing since 2006. For yearend 2008, delinquent credit card debt to total outstanding credit card debt was 1.9 percent, and delinquent credit card debt to total outstanding loans was 0.1 percent.

<b>Credit Card Delinquency Trends</b>			
<b>Date</b>	<b>Total Credit Card Debt To Total Loans</b>	<b>Delinquent Credit Card Debt To Total Credit Card Debt</b>	<b>Delinquent Credit Card Debt To Total Loans</b>
12/31/2004	5.44%	1.27%	0.07%
12/31/2005	5.22%	1.17%	0.06%
12/31/2006	5.37%	1.04%	0.06%
12/31/2007	5.71%	1.34%	0.08%
12/31/2008	5.78%	1.88%	0.11%

The following Credit Card Charge-Off Rates table reveals increasing losses relative to credit card services. Both the increasing delinquency and loss rates are not unexpected in today's economic conditions. The increase in credit card charge-off rates indicates federally insured credit unions are appropriately recognizing the losses associated with this unsecured debt.

<b>Credit Card Charge-Off Rates</b>		
<b>Date</b>	<b>Net Credit Card Charge-Offs To Total Credit Card Debt</b>	<b>Net Credit Card Charge-Offs To Total Loans</b>
12/31/2004	2.01%	0.11%
12/31/2005	2.13%	0.11%
12/31/2006	1.48%	0.08%
12/31/2007	1.61%	0.09%
12/31/2008	2.72%	0.16%

Independent industry research indicates that the fees, rates, and terms of the largest United States credit card providers compared poorly to credit cards issued by credit unions with similar purchase interest rates. Federally insured credit union credit card products tended to have fewer fees, lower fees, and clearer disclosures. The study concluded there is a clear difference between credit cards issued by banks and those



issued by federally insured credit unions. The terms and conditions of credit cards issued by the large banks are generally more complex than those of the large federally insured credit union issuers. Those complexities are likely to result in the bank customers not understanding the full cost of using the cards and, therefore, incurring much higher fees. The details of federally insured credit union credit card programs show credit card lending is sustainable without exorbitant penalties and misleading terms and conditions.<sup>11</sup>

#### **IV. Overdraft Protection Programs**

The Agencies have been concerned about overdraft protection programs for several years. In September 2004, the Federal Financial Institution Council (FFIEC)<sup>12</sup> published an informational brochure entitled *Protecting Yourself From Overdraft and Bounced-Check Fees*.<sup>13</sup> The purpose of the brochure is to educate consumers about overdraft programs and to provide information on alternative methods of covering overdrafts that may be less expensive.

In 2005, the NCUA participated with three other member agencies of the FFIEC in issuing guidance addressing several aspects of overdraft protection programs.<sup>14</sup> The guidance focused on automated systems that have largely replaced the more traditional, *ad hoc* types of programs financial institutions historically used to determine

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<sup>11</sup> The Woodstock Institute, *Blindfolded Into Debt: A Comparison of Credit Card Costs and Conditions at Banks and Credit Unions*, July 2005.

<sup>12</sup> FFIEC is composed of the five federal financial regulators, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, and the State Liaison Committee.

<sup>13</sup> The brochure is available for download from the NCUA's website at [www.ncua.gov](http://www.ncua.gov).

<sup>14</sup> 70 Fed. Reg. 9127 (February 24, 2005).

whether to pay an item despite insufficient funds. The guidance included a discussion of best practices and recommended, but did not require, institutions provide consumers with an opt-out notice.

The NCUA and the FRB have regulated the disclosures associated with overdraft protection programs using authority under the Truth in Savings Act (TISA).<sup>15</sup> Following an amendment to 12 C.F.R. part 230 (Regulation DD) in 2005,<sup>16</sup> The NCUA amended its TISA rule to address concerns relating to the uniformity and adequacy of fee disclosures in connection with overdraft programs.<sup>17</sup> The amendment created a new requirement for federally insured credit unions that promote the payment of overdrafts in advertisements to disclose fees and other information.

To address continued concerns about the fees consumers pay for overdraft services, Regulation DD recently extended the disclosure requirements for overdraft fees to all banks, regardless of whether they market their overdraft protection programs.<sup>18</sup>

Regulation DD now requires banks to disclose the periodic and year-to-date totals for overdraft protection fees a consumer pays on every periodic statement. The NCUA Board is proposing a substantially similar amendment to Part 707 of the NCUA's regulations for federally and privately insured credit unions.

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<sup>15</sup> 12 U.S.C. 4301 *et seq.*

<sup>16</sup> 70 Fed. Reg. 29582 (May 24, 2005).

<sup>17</sup> 70 Fed. Reg. 72895 (December 8, 2005).

<sup>18</sup> 74 Fed. Reg. 5584 (January 29, 2009).

Additionally, the FRB has proposed additional requirements for overdraft protection programs under Regulation E.<sup>19</sup> The proposed rule would limit a financial institution's ability to assess overdraft fees for paying automated teller machine (ATM) withdrawals and one-time debit card transactions that overdraw a consumer's account, unless the consumer is given the right to opt-out of the overdraft protection program and does not opt-out. The proposed rule offers a right of opt-in as an alternative regulatory approach. Additionally, the proposed rule would prohibit financial institutions from assessing a fee if an overdraft is caused solely by a debit hold on funds in a consumer's account that exceeds the actual amount of the transaction. If finalized, the proposed amendment to Regulation E would apply to federally and privately insured credit unions.

*Overdraft Protection Fees.* The NCUA's Call Report does not collect specific data concerning fee income on individual services; however, the Call Report does collect total fee income. The NCUA's Financial Performance Report computes a net operating expense/average assets ratio (fee income is reduced by expenses in the numerator). This ratio considers the relationship of fee revenue and expenses. Total fee income, the net operating expense ratio, and return on assets, provides insight into a federally insured credit union's fee income.

Examiners consider the reasonableness of fee income when reviewing federally insured credit union programs. Fee income, if excessive, can create safety and soundness issues depending on what the officials do to generate the fees and how the funds are spent. For overdraft programs, the NCUA's general lending regulations require

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<sup>19</sup> 74 Fed. Reg. 5212 (January 29, 2009).

federally insured credit union boards of directors to establish a policy and the fees for overdraft protection programs.<sup>20</sup>

Although there is no statutory or regulatory ceiling that specifically limits the amount of fees a federal credit union may assess, market forces work to impose reasonableness in this area. Some states regulate in this area and impose a ceiling on the fee state credit unions may charge for overdraft services. Examiners, in addition to compliance risk, consider the effects of fees on other risk categories of the risk-based examination, i.e., strategic, reputation, credit, liquidity, and transaction risks.<sup>21</sup> The NCUA CAMEL Rating System also evaluates the composition of earnings, which includes fees.<sup>22</sup>

The examiner's review of Call Report and Financial Performance Report data provides insight if a federally insured credit union is generating increased fee income relative to operating expenses, product growth, and return on assets. Peer data available to examiners helps identify outliers, and the NCUA generates internal risk reports to isolate and monitor trends and risk.

Fee schedules, disclosures, and annual percentage yield calculations provide federally insured credit union members a basis to compare the cost of having a share draft or other demand account. Federally insured credit unions market and compare their

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<sup>20</sup> A federally insured credit union must have policies that: set a cap on the total dollar amount of all overdrafts it will honor consistent with its ability to absorb losses; establish a time limit not to exceed 45 calendar days for a member either to deposit funds or obtain an approved loan to cover each overdraft; limit the dollar amount of overdrafts it will honor per member; and establish the fee and interest rate to charge members for honoring overdrafts. 12 C.F.R. §701.21(c)(3).

<sup>21</sup> The NCUA Letter to Federal Credit Unions 02-FCU-09, *Risk-Focused Examination Program* (May 2002).

<sup>22</sup> NCUA Letter to Credit Unions 07-CU-12, *CAMEL Rating System* (December 2007).

products and services to be competitive. In some cases, federally insured credit unions have low minimum balance requirements making a service more cost effective for members. Some other financial institutions limit the services offered to their customers with lower balances, including restricting access to personal assistance. A federally insured credit union sometimes receives financial support from a sponsoring employer, which allows the federally insured credit union to charge lower fees. The NCUA's risk-focused examination approach focuses on whether or not management can support the fees charged for the type of service provided.

*Oversight Effectiveness.* To date, the NCUA has not taken formal enforcement action concerning overdraft fees. The NCUA has effectively used examiner findings, documents of resolution, warning letters, and letters of understanding/agreement to resolve issues. However, enforcement action is available if necessary.

Review of the NCUA's examination and supervision program reveals minimal violations, in 2008, regarding federally insured credit union overdraft protection programs. The NCUA examiners issued eighty-six documents of resolution to addressing overdraft protection program weaknesses.

Beyond relying upon the examination and supervision program to identify emerging issues and concerns, The NCUA also relies upon the member complaint process. Each NCUA regional office has staff dedicated to reviewing member complaints. Typically, when the NCUA receives a member complaint, staff forwards it to the supervisory

committee for the named federal credit union or appropriate state supervisory authority for investigation and a response to the complaining member. Federal credit unions generally resolve their members' complaints voluntarily. Therefore, no member complaint has resulted in an enforcement action related to fees and disclosures on share and demand accounts. The NCUA, however, will invoke its authority to take an administrative action against a credit union if necessary to achieve the proper outcome.

Unlike traditional lines of credit, overdraft protection programs do not require individual underwriting or written agreements. Instead, federally insured credit unions choose to honor drafts, up to an aggregate dollar amount, even if there are insufficient funds in a member's account to pay the drafts. Members are charged a per item fee for this service, and outstanding amounts must be quickly repaid.

The NCUA encourages federally insured credit unions to advise members about less costly products and consider suspending access to overdraft protection when members repeatedly access it. For example, a federally insured credit union may choose to limit the number of overdraft transactions to be covered for a member or it may choose to contact members and describe other available options. Members may qualify for other types of loan products based on successful repayment under an overdraft protection program.

## **V. Potential Impact of Proposed Legislation on Credit Union Industry**

Credit cards and overdraft protection programs are useful member services. Currently, approximately 3,973 federally insured credit unions issue credit cards to their members.<sup>23</sup> The aggregate outstanding balance on these portfolios is approximately \$32.7 billion, a small portion of the credit card debt nationwide.<sup>24</sup> Increasing credit card delinquency and losses could lead to increased fees relative to credit card services. However, the NCUA believes it has the proper controls and oversight in place to ensure any abuse is appropriately identified and addressed. The NCUA will continue to monitor federally insured credit union credit card programs and services to ensure unfair and deceptive practices do not materialize.

Approximately 2,804 federally insured credit unions offer overdraft protection services. The NCUA recognizes overdraft protection programs can benefit both credit unions and credit union members if members rarely access the program. Federally insured credit unions receive another source of fee revenue and members avoid the inconvenience and subsequent fees associated with returned checks. To promote fiscal responsibility and to help members make informed choices, federally insured credit unions offering overdraft protection programs should continue to educate members about costs, program details, and less expensive options.

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<sup>23</sup> The data is current as of the December 31, 2008 financial reporting cycle.

<sup>24</sup> According to the Federal Reserve Statistical Release G.19 Consumer Credit (July 8, 2008), total outstanding revolving credit in America was estimated at \$962 billion in May 2008.

While overdraft protection programs may assist infrequent users in avoiding the inconvenience and merchant fees associated with returned checks, repeat use of overdraft protection can result in high aggregate fees that negatively impact a member's financial position. Notwithstanding the concerns regarding excessive fees, the NCUA is concerned with regulating overdraft protection programs under TILA because treating overdraft fees as a finance charge will affect federal credit unions' ability to offer overdraft services to their members.<sup>25</sup>

## **VI. Conclusion**

Briefly summarized, the NCUA believes the UDAP rule addresses most of the practices and problems to which H.R. 627 is directed. To the extent areas of concern remain, The NCUA is prepared work to with its sister agencies to address those problems. Regarding overdraft protection regulations, recent changes in the TISA rule and the regulatory proposal from the FRB address key areas of concern to which H.R. 946 is directed. The NCUA believes it is unnecessary to include overdraft protection fees within the meaning of a finance charge because current and proposed regulations will provide an opt-in or opt-out right for overdraft protection programs and full disclosure regarding associated fees. Moreover, including overdraft fees within the meaning of finance charges for purposes of Regulation Z would make it difficult for FCUs under current NCUA policy to offer the service.

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<sup>25</sup> The Federal Credit Union Act limits the amount of interest, including finance charges, federal credit unions can charge on loans. 12 U.S.C. 1757(a). Federal credit unions are subject to a statutory interest ceiling of 15%, which the NCUA Board may adjust based on various factors. The current maximum interest rate for federal credit unions is 18 percent. NCUA Letter to Federal Credit Unions, *Permissible Interest Rate Ceiling* (January 2008). The NCUA's long-standing policy is to include all finance charges, as defined under Regulation Z, in computing the permissible interest rate.



The NCUA is to providing strong regulatory and supervisory controls and monitoring federally insured credit unions to ensure member protection. As the Agencies continue deliberations policies that would prevent unfair or deceptive practices in credit card lending and overdraft protection programs, the NCUA will continue to ensure compliance with all federal laws and fulfill its enforcement responsibilities for any regulatory or statutory changes.