Bank and Credit Union Officials:
APR is not a good measure of short-term credit

A March 19, 2009 hearing in the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit, addressed legislation requiring banks and credit unions to calculate overdraft protection fees as an annual percentage rate (APR) under the Truth in Lending Act (TILA). Bank and credit union officials testified that APR was not an accurate measurement of short-term credit.

Kenneth J. Clayton, American Bankers Association (ABA):

"Any time an annual percentage rate is calculated for a term less than a year, the inclusion of a fixed fee, even a modest one, will distort and overstate the APR. The shorter the repayment period, the greater the APR will appear in instances where there is a fixed fee. This means that the sooner the consumer repays, the greater the calculated APR – a difficult concept to explain to consumers, as it appears that paying earlier actually increases the cost of credit."

"Given the nature of overdraft fees, the APR will be greatly inflated to the point of distortion. In these cases, the fee is fixed, the overdraft often small, and the term of repayment short (as the banking agencies encourage banks to request prompt repayment). It is easy to see how triple digit APRs would result. However, it is not at all clear how this would assist consumers. Rather, the inflated and distorted APR will confuse consumers as they attempt to reconcile this APR with other APRs with which they are familiar, such as the APRs for credit card, home, auto, and personal loans."

"The result will be to dilute the effectiveness of the APR generally, rather than enlighten them with regard to overdrafts. In the overdraft fee context, consumers understand a dollar amount far better than an inflated and meaningless APR."

Douglas Fecher, On Behalf of the Credit Union National Association (CUNA):

"CUNA opposes treating overdraft programs under the Truth in Lending Act because we do not believe that this service is a lending product."

"…if this bill were law, it would cause credit unions offering these [overdraft] programs to exceed the usury ceiling prescribed by the Federal Credit Union Act (presently at 18%), since even a modest fee would exceed this threshold. As a result, credit unions subject to the usury ceiling would no longer be able to offer these services, driving members of these credit unions to alternative – and perhaps more expensive – financial services providers. Moreover, we do not believe that the disclosure of an APR on an activity of this nature will be particularly helpful to the consumer."

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Linda Echard, On behalf of the Independent Community Bankers of America:

"ICBA also believes overdraft protection programs should not be subject to the Truth in Lending Act (TILA). Regulation and disclosure under TILA is appropriate for open-ended accounts, such as credit cards, where a consumer is offered and extended credit and has certain rights and obligations regarding using and repaying it."

"The disclosures provided under TILA are based on specific principal amounts and defined terms, elements lacking when overdrafts occur since customers are charged a flat fee, not an interest rate."