

August 17, 2015



## REGULATORY UPDATE

# Overdraft Privilege Compliance Alert: Debit Hold Considerations

### Background

Consumers are handling more and more of their transactions electronically and the payment and processing systems used by our industry are becoming increasingly complex. This combination of factors has led to a rise in account holder confusion as to exactly when payments will be made from their accounts.

In response, the Federal Reserve amended several regulations in an attempt to provide more transparency and consistency in disclosures and balances. One requirement was to provide a balance both on statements and at ATM machines that most accurately reflected the "customer's own funds" (Reg DD).

Another limited the authorization for POS and ATM transactions when the customer's funds were considered to be insufficient for the item to be expected to be paid when presented (Reg E). In the rule writing the Federal Reserve was careful not to use terms such as ledger balance or available balance since these terms vary among institutions and most systems have multiple available balance tables with various items adding to or subtracting from the system's base balance.

In the writing of Regulation E, the Federal Reserve introduced another key payment concept. While the argument had been presented that a preauthorized POS debit was similar to a certified check based on the merchant agreement between the card issuer and the bank to guarantee payment, the regulation looks more to the presentment of the actual item, and prohibits charging NSF fees for these paid items when the account balance is insufficient (without the "Reg E opt in").

While ATM and PIN based debit transactions clear immediately or in very close proximity to their time of origin, the "signature based" transactions processed by card issuers over the slower credit processing channels create longer timing differences as merchants often save and batch their transmissions of the actual items for payment. To protect against loss on the guaranteed payments, given the associated "credit risk," financial institutions placed "debit holds" on accounts for each item authorized until the item was presented and paid. Consumer confusion builds as certain holds are not removed when the item clears and available balances shown reflect lower balances than the account holder's own funds.

### Need to Inform and Protect Consumers

In 2012, Federal Bank Examiners began seeing overdraft fees on statements where the end of day balances shown were positive. This led to periodic criticism and potential Unfair and Deceptive practice violations.

In March 2013, the Federal Reserve presented a "Consumer Compliance Outlook" webinar on the issue to the industry and listed this practice as a UDAP violation labeled "Overdraft Billing." The practice was cited as: "The banks method of posting point-of-sale debit transactions resulting in multiple overdraft fees for a single POS debit transaction."

The Federal Reserve's rule making authority in this area has been transferred to the Consumer Financial Protection Bureau (CFPB) and that agency has been actively engaged in studying overdraft practices and the need for potential rule revisions. In its publication, *Supervisory Highlights: Winter 2015* issued in December 2014, the CFPB provided a lengthy dissertation on balance definitions in the calculation of fees for debit card transactions and disclosures. They concluded that "...because consumers were substantially injured or likely to be so injured by overdraft fees assessed contrary to the overall net

impression created by the disclosures (in a manner not outweighed by countervailing benefits to consumers or competition), and because consumers could not reasonably avoid the fees (given the misimpressions created by the disclosures), the practice of assessing the fees under these circumstances was found to be unfair.” While the article tends to oversimplify the different balances that institutions can use for the various channels and for authorizations, payments, and fee assessments as either ledger or available, the CFPB has made it clear that certain debit holds may not be used in considering charges unless properly and *very clearly* disclosed.

### Pinnacle ODP Program in Line With CFPB

Pinnacle Financial Strategies’ overdraft privilege program is a regulatory compliant and profitable program that provides a genuine service to consumers with complete and understandable disclosures, reasonable fees and clear choices. Pinnacle has consistently and strongly advocated adjusting available balances to not include debit holds when considering NSF charges. We continue to encourage institutions to follow the agencies’ and CFPB’s preferred practice of not charging for overdrafts created by debit holds, and we continue to recommend prompt and unsolicited refunds when these relatively rare situations occur.

Our experts have worked with numerous core providers in an effort to have code written to prevent this situation and many providers have done so. We urge our clients to verify that their core can adjust for debit holds when charging for overdrafts and apply the proper parameter settings to avoid unfair fees. In those cases where the core provider has not provided the available balance adjustment for debit holds when assessing charges, we recommend procedures be established to monitor for this situation to enable prompt and unsolicited refunds.

With the CFPB’s added emphasis on how improper disclosures by financial institutions create consumer confusion with UDAP consequences, Pinnacle continues to promote complete, informative and accurate disclosures that consumers can understand.

For more information on overdraft programs that are fully automated, fully disclosed and fully in compliance, contact us at 800.741.7758 or [info@pinnstrat.com](mailto:info@pinnstrat.com)



Pinnacle Financial Strategies provides customizable performance measurement programs, overdraft privilege services, streamlined account opening, debit card program optimization, cash back rewards programs and business banking solutions to help institutions gain a competitive edge, attract and retain accountholders, and improve profitability.

©2015 Pinnacle Financial Strategies