

FALL 2019

## REGULATORY UPDATE

### Is Your Courtesy Overdraft Program Putting Your Financial Institution at Risk?

While there have not been any recent substantive changes or amendments to the various Regulations and Laws governing Overdraft Programs or practices, we are seeing numerous examples of compliance examiners citing institutions as having Unfair and Deceptive programs, sometimes with Civil Monetary Penalties (CMP's) and the requirement for refunds to consumers of certain paid overdraft fees. Quite often, these programs and fees appear to be on the surface in full conformance with the existing regulations and guidance; however, because of a lack of transparency as viewed and determined by a compliance examiner, these programs have been deemed to contain Unfair or Deceptive Acts or Practices (UDAP) and to be in violation of the FTC Act.

We are also seeing numerous Class Action Lawsuits that follow the same premise where again, the lack of clear disclosures, or misleading disclosures, provide the basis for a class action suit and the demand for fee refunds for the entire deposit base.

Our Fall 2019 Regulatory Update lays out many of the recent citations that we have seen either in client institutions, in press releases, or as defined in informal regulatory compliance publications. We have also included some of the other older common errors that we have seen cause violations of regulations in the past.

We provide this document for Compliance Officers, Operations Managers, and ODP Program Managers. We urge each to review both the operational aspects of the FI's Courtesy Overdraft Program along with all related documents and disclosures to ensure accuracy and transparency.

This is not a time for complacency. Do not get caught off guard by these evolving interpretations of the FTC Act by regulators, consumer activists and law firms.

## UDAP / CLASS ACTION LAWSUITS

### CHARGING OD FEES AT POSTING USING AN AVAILABLE BALANCE THAT INCLUDES DEBIT HOLDS

Financial services have evolved rapidly over the past 20 years with an increasing reliance on various electronic payment systems to move funds from accountholders to merchants and other payees. These various payment systems have created a shift in bank operations from the basic posting of items received, to tracking items authorized within some of these payment vehicles, with an effort to anticipate what the customer's balance will be at posting time, and for consideration of additional authorizations. For example, when financial institutions (FIs) authorize transactions created by Debit Cards that are presented at merchant's Point of Sale (POS) terminals, the FI becomes obligated to pay those amounts, which creates some level of credit risk and exposure due to timing differences between the item's authorization and when it actually clears and posts to the account. In an attempt to manage this risk, the industry has created a second balance generally referred to as the Available Balance, which begins with the Current or Ledger Balance, typically shown on the periodic statement, with authorized amounts that have not yet cleared (Debit Holds) subtracted, along with other debits and deposits known but not yet posted to the account.

When the determination of an overdraft and the fees charged are based solely on this available balance, numerous situations are created where multiple fees will be charged for a single overdrawn item, which has often been cited as an Unfair or Deceptive Act or Practice (UDAP) under the FTC Act. This situation is described with an example in the following excerpt from the noted regulatory publication.

*"Institutions' processing systems utilize an "available balance" method or a "ledger balance" method to assess overdraft fees. The FDIC identified issues regarding certain overdraft programs that used an available balance method to determine when overdraft fees could be assessed. Specifically, FDIC examiners observed potentially unfair or deceptive practices when institutions using an available balance method assessed more overdraft fees than were appropriate based on the consumer's actual spending or when institutions did not adequately describe how the available balance method works in connection with overdrafts.*

*For example, a consumer might begin the day with an account balance of \$50 and engage in a \$30 POS signature-based transaction. That transaction would authorize against a sufficient positive balance and would lower the consumer's available balance to \$20. If the consumer authorized another \$30 transaction, the*

*second transaction would authorize against an insufficient available balance and lower the consumer's available balance to negative \$10 (-\$10). If the first transaction settled after the second transaction had posted, and if the institution's payment system assessed overdraft fees at final settlement, both transactions would be assessed overdraft fees, despite the fact that the consumer's balance was sufficient to cover the first transaction at the time the transaction was authorized."*

*- Source: FDIC Consumer Compliance Highlights, June 2019*

The following excerpt also points out the additional fees created by the use of the available balance method for calculating OD fees as compared to the ledger balance method.

*"Bureau examiners observed that one or more financial institutions switched from a ledger-balance method to an available-balance method for purposes of deciding whether to authorize signature-based debit transactions and other electronic transactions (collectively "electronic transactions") and whether to post or return checks and ACH transactions. In addition, one or more institutions switched to an available-balance method for purposes of calculating whether a transaction results in an overdraft and/or whether an overdraft fee is assessed when a transaction is settled.*

*A ledger-balance method factors in only settled transactions in calculating an account's balance; an available-balance method calculates an account's balance based on electronic transactions that the institutions have authorized (and therefore are obligated to pay) but not yet settled, along with settled transactions. An available balance also reflects holds on deposits that have not yet cleared. Examiners observed that in some instances, transactions that would not have resulted in an overdraft (or an overdraft fee) under a ledger-balance method did result in an overdraft (and an overdraft fee) under an available-balance method.*

*At one or more financial institutions, examiners noted that these changes to the balance-calculation method used were not disclosed at all, or were not sufficiently disclosed, resulting in customers being misled as to the circumstances under which overdraft fees would be assessed. Because these misleading practices could be material to a reasonable consumer's decision-making and actions, they were found to be deceptive."*

*- Source: CFPB's Supervisory Highlights, Winter 2015*

We have also seen some institutions charging fees at authorization time as well as at posting, resulting in fees when the actual current balance never becomes negative. While regulations do not currently prohibit the use of available balance for charging purposes, the fact that it can create multiple fees for single items creates what a reasonable person might consider not only unfair but a potentially abusive program. While we are unaware of any OD Programs being cited by regulators as abusive specifically, the Dodd-Frank Wall Street Reform and

Consumer Protection Act of 2010 gave the authority to CFPB regulators to evaluate consumer financial products based on a new UDAAP assessment, in addition to the traditional UDAP tests. UDAAP is an acronym referring to unfair, deceptive, or abusive acts or practices. With the increasing scrutiny of OD Programs, we only point out that there are more tools in the regulatory toolbox that we have yet to see used.

When an available balance is used for posting and charging, it is recommended that debit holds be dropped from the fee assessment process if the core deposit platform provides this option.

Pinnacle's recommendation is to use the current balance for posting and fee assessment, with clear disclosures provided on exactly how the program authorizes and assesses fees, and the balances used.

### **CHARGING OD FEES FOR SIGNATURE POS DEBIT ITEMS THAT POST TO A NEGATIVE BALANCE, BUT THAT WERE AUTHORIZED WHEN THE AVAILABLE BALANCE WAS POSITIVE**

This situation is a very common one for any institution that authorizes and pays overdrafts for consumers who have voluntarily opted in for such additional coverage in accordance with Regulation E. When institutions are following the generally recognized recommended practice of authorizing on an available balance, and posting and charging on a current balance, there will be various scenarios where items that are authorized on a positive available balance will post and be charged as an overdraft when the current balance may have become negative or insufficient to cover the item, due to timing differences from merchant processing delays.

We do note the converse often happens as well where a Debit POS item may be authorized using the OD Program limit, but a deposit is made before the item posts. In these situations, while the consumer received the benefit of the program authorizing payment with insufficient available funds, there is no fee assessed since the program looks at the current balance at the time of posting for the fee assessment.

Nevertheless, examiners from several agencies have been citing this as a UDAP, since they perceive that the consumer should not expect to be charged when the item was authorized without using the program limit, even though Reg E provides for the charging for ATM and One-Time Debit items if the customer has opted in and the program is available to them.

This situation appears to be resolved with a very clearly presented disclosure that explains that items are charged based on the account balance at item posting, and that their balance at authorization time does not affect the determination of fees.

Since this appears to be a disclosure issue, most core providers have not provided any ability to identify such items, often referred to as Authorized Positive-Posted Negative (APPN) items.

We are aware of at least two live real-time core providers that have provided a capability to "mark" debit items when authorized and indicate whether it was authorized using a positive balance or not. At posting time, even if the consumer has opted in, the FI is given a parameter setting that provides the opportunity to NOT charge for APPN items. Unlike the traditional memo posting end-of-day batch processing systems, where credits received during a daily period are posted before debits, a live real-time system will post items as they are received throughout the day. This allows for the assessment of fees for what may be referred to as daylight overdrafts. In this scenario, a positive end of day balance may have a debit item post at noon that overdraws the account, and a deposit made at 2 PM to cover the transaction resulting in a positive end of day balance, but with an OD fee charged for the item that caused the account to be negative for a brief period of time. While transparency with full and easily understood disclosures should also prevent UDAP claims, FIs that have these parameter settings should consider deploying them to prevent charging for APPN items.

Following are excerpts from two regulatory publications that address this issue where it has been considered a UDAP situation.

From the *Federal Reserve board's Consumer Compliance Supervision Bulletin*, dated July 2018:

*"In particular, certain bank practices related to charging overdraft fees to consumers have been identified as unfair or deceptive acts or practices in violation of section 5 of the FTC Act. UDAP violations and risks have been identified when a bank makes misleading omissions or representations concerning its overdraft program. In addition, unfair or deceptive practices have arisen in connection with the use of third-party vendor software to process overdraft transactions and assess overdraft fees.*

*For example, the Federal Reserve has cited an unfair or deceptive practice based on a certain overdraft processing methodology applied to point of sale (POS), signature-based transactions. In effect, the UDAP violation occurred when a bank imposed overdraft fees on POS transactions based on insufficient funds in the account's available balance at the time of posting, even*

*though the bank had previously authorized the transaction based on sufficient funds in the account's available balance when the consumer entered into the transaction. There can be a delay of one to a few days between the authorizing and posting of a POS transaction, during which time the account's available balance may have decreased and the POS transaction could exceed the account's available balance at the time of posting. Charging an overdraft fee on the POS transaction in this circumstance was found to violate section 5 of the FTC Act."*

It is important to note that the advisory specifically notes this case when there is an "omission" or "misrepresentation" in the disclosed information. While we may assume the practice is disliked by regulators, this seems to indicate the situation may be rectified with clear and easy to understand disclosures.

From the CFPB's Supervisory Highlights, Winter 2015:

*"At one or more institutions, examiners found deceptive practices relating to the disclosure of overdraft processing logic for electronic transactions. Examiners noted that these disclosures created a misimpression that the institutions would not charge an overdraft fee with respect to an electronic transaction if the authorization of the transaction did not push the customer's available balance into overdraft status. But the institutions assessed overdraft fees for electronic transactions in a manner inconsistent with the overall net impression created by the disclosures. Examiners therefore concluded that the disclosures were misleading or likely to mislead, and because such misimpressions could be material to a reasonable consumer's decision-making and actions, examiners found the practice to be deceptive. Furthermore, 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."*

We once again see that the disclosure is deemed to present a misimpression, indicative of a lack of transparency and inadequate disclosure resulting in the UDAP claim, as opposed to the sole act of charging for APPN items.

## RETURNED ITEM FEES (NSF FEES)

There have recently been several class action lawsuits filed against FIs for charging an NSF fee multiple times on the same item. In one example cited in a lawsuit, a transaction in the amount of \$25.00 was presented five times for payment, resulting in an NSF fee of \$36.00 to

the accountholder each time, for a total of \$180.00 in fees. We recommend that all FIs review their Account Agreements (Terms and Conditions), Fee Schedules, overdraft policies and any other account documents disclosing your practice of handling and charging for NSF items. FIs need to ensure the documents match your actual practices and clearly describe how and when NSF fees are charged.

## MISLEADING CONSUMERS ON HOW ELECTRONIC ITEMS ARE PRESENTED AND POSTED

Since we often see references to the fact that examiners found deceptive practices relating to the disclosure of overdraft processing logic for electronic transactions, we note that many institutions still disclose check processing orders as low to high, check number order, etc. as suggested by earlier best practices in interagency guidance for OD Programs. We note that these disclosures more than likely do not match actual practices, since Check 21 conversions and other methods of check conversion to electronic items impact the way checks clear and post. We recommend FIs review their program brochures and ensure they have properly explained the nature of the electronic conversion and posting process for checks as well as other debits and credits.

## REGULATION E

### CHARGING OD FEES FOR ATM AND POS ITEMS WHEN THE OD PROGRAM LIMIT IS NOT AVAILABLE

There are two similar situations that cause a violation of Regulation E. The first is when the account holder opts in during account opening, and the FI has a waiting period before the OD limit is made available. Regulators have long held that a consumer may not be charged OD fees for one-time debit card transactions if there is no benefit derived from the authorization of such debit card transactions when there is a negative available balance.

This may occur during waiting periods and when an OD Limit is revoked, and the "Opt-In" switch on the Core Deposit Platform is in a setting that provides for the charging of ATM and POS items.

This situation is clearly described in the *FDIC Chicago Region's Quarterly Newsletter of June 30, 2018*. The newsletter instructs institutions to remedy any such actions that are found, and to provide voluntary restitution to all affected consumers.



## CHARGING DAILY OD FEES WHEN THE ACCOUNT BECOMES OVERDRAWN BECAUSE OF ATM AND POS ITEMS WHEN THE ACCOUNT HOLDER HAS NOT OPTED IN

An FI is prohibited from assessing any fee based on the amount of an outstanding negative balance if the negative balance is solely attributable to an ATM or one-time debit card transaction, unless the consumer has opted in for ATM and debit card coverage. This would include daily or sustained overdraft fees, a negative balance fee or similar fees or charges.

## A-9 ERRORS (REGULATION E OPT-IN FORM)

Several institutions have not properly disclosed fees or are adding language not specifically allowed by the regulation. It is important to be familiar with and comply to the limitations on the permitted changes to the A-9 form. We recommend you review your A-9 to ensure it has not been modified in ways that are not permitted in Regulation E.

We also note that the maximum fees charged is often understated when Daily OD fees are charged. To correctly disclose the Maximum Daily Fees, you must add the daily fee, if any, to the Maximum Number of OD fees. For example, if you charge 5 fees a day @ \$35.00 each and have a daily fee of \$10.00 after 10 days, the maximum amount you may charge should be stated as \$185.00 (5 x \$35 + \$10.00).

Pinnacle strongly discourages daily fees for Courtesy Overdraft programs.

## ECOA / REGULATION B

### PRODUCTS RESTRICTED BY AGE ("SENIOR CHECKING")

It is not uncommon for financial institutions to offer checking products designed for seniors with special perks or features, including more favorable terms on credit components such as a credit card or other loan product. This is permitted under Regulation B for those individuals meeting the definition of "elderly", which is 62 year of age or older. The banking industry has long understood that if the minimum entry age for the product is not age 62, the credit feature(s) may not have more favorable terms than those offered to persons under age 62.

We want to ensure discretionary overdraft privilege programs (ODP), which are incidental credit under

Regulation B, are considered in the same manner as other credit products.

If the eligibility age for your senior product is less than 62 years, there are two specific areas related to overdrafts that you should be aware of. They are:

- 1). ODP Limit
- 2). Monthly Service Charge

To illustrate our concerns regarding the limit and monthly fees, we are going to use this **example**:

The financial institution offers these products:

- Basic Checking - \$300 ODP Limit and a \$5.00 monthly service charge.
- Interest Checking - \$750 ODP Limit and a \$10.00 monthly service charge if a specified minimum balance is not maintained.
- "Senior" Checking - Similar to the Basic Checking account except there is a \$500 ODP Limit and the monthly service charge is waived. This product is for those 55 and older.

**ODP LIMIT** - In the above scenario, the ODP Limit on Senior Checking is higher than the limit on Basic Checking. While individuals between the ages of 55 and 62 can benefit from a higher ODP Limit of \$500, individuals younger than 55 are not able to benefit from the same \$500 limit due to not meeting the entry age for Senior Checking. Providing more favorable "credit" terms to individuals between the ages of 55 to 62 compared to younger customers has been considered discriminatory and a violation of Reg B by regulators.

**MONTHLY FEES AND OVERDRAFTS** - We have seen FDIC examiners take the position that the payment of monthly fees on a checking account is to access the services of that account, which they have determined also includes the payment of overdraft items. They have considered this a service of the account, regardless of whether overdrafts are paid on an ad hoc basis or under a disclosed program.

To illustrate, in the previous example, individuals in the Basic Checking account are paying a \$5.00 monthly service fee, while individuals in the Senior Checking do not have a monthly fee. In the opinion of the FDIC examiners, customers between the ages of 55 to 62 can have access to the overdraft service for free while those younger than 55 cannot. Since credit is being made available to individuals between the ages of 55 to 62 on more favorable terms than those individuals that don't qualify for the Senior Checking due to age, the FDIC examiners have maintained this situation to be in violation of Reg B.

Pinnacle recommends financial institutions review their products and associated ODP Limits and product fees.

## SUMMARY

A courtesy OD programs should provide a beneficial service to the consumer, which will in return provide additional fee revenue for the financial institution.

For a program to be successful, it should:

- Be fair and transparent with clear brochures and disclosures and assure that the account agreements and Reg DD fee disclosures are correct and accurately presented (match actual practice).
- Comply with all laws and regulations.
- Use the proper core parameter settings for authorizing and posting balances and making fee assessments.
- Have reasonable fees for the services provided.

As always, please feel free to contact your Client Services Manager or Client Care at [clientcare@pinnstrat.com](mailto:clientcare@pinnstrat.com) for assistance with your program, or information regarding our updated brochure and ODP Policy that incorporates changes to address many of the above concerns.

## REFERENCES

*FDIC Consumer Compliance Supervisory Highlights Insight June 2019*

<https://www.fdic.gov/regulations/examinations/consumer/complsupervisoryhighlights.pdf>

*CFPB's Supervisory Highlights, Winter 2015*

[https://files.consumerfinance.gov/f/201503\\_cfpb\\_supervisory-highlights-winter-2015.pdf](https://files.consumerfinance.gov/f/201503_cfpb_supervisory-highlights-winter-2015.pdf)

*FDIC Chicago Region's Quarterly Newsletter of June 30, 2018*

<http://www.cbai.com/downloads/2QFDICNewsletter063018.pdf>

*Federal Reserve board's Consumer Compliance Supervision Bulletin, dated July 2018*

<https://www.federalreserve.gov/publications/2018-july-consumer-compliance-supervision-bulletin.htm>

*Regulatory Action: CFPB Fines Regions Bank \$7.5 Million for Unlawful Overdraft Practices. In addition, Bank Refunds \$49 Million in Illegal Fees to Consumers Who Did Not Opt-In to Overdraft Practices.*

<https://www.consumerfinance.gov/about-us/newsroom/cfpb-fines-regions-bank-7-5-million-for-unlawful-overdraft-practices/>

*Regulatory Action: CFPB Orders Santander Bank to Pay \$10 Million Fine for Illegal Overdraft Practices*

<https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-orders-santander-bank-pay-10-million-fine-illegal-overdraft-practices/>

*Class Action: Navy Federal Credit Union has agreed to settle a class action lawsuit over its overdraft fees for \$24.5 million*

<https://www.cutoday.info/Fresh-Today/Navy-FCU-Agrees-To-Settle-Class-Action-On-Overdrafts-For-24.5-Million>

*Class Action: City National Bank Improperly Charged Multiple Non-Sufficient Funds Fees for Single Transactions*

<https://www.classaction.org/news/class-action-city-national-bank-improperly-charged-multiplenon-sufficient-funds-fees-for-single-transactions>