FDIC Overdraft Payment Supervisory Guidance
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Introduction

On November 24, 2010 (the day before Thanksgiving), the FDIC published its final “Overdraft Payment Supervisory Guidance.” Although there were more than 900 written comments from banks, trade associations and consumers and their advocacy groups, there were virtually no meaningful changes in the final guidance from the draft published on August 11, 2010. Also, this guidance, unlike the 2005 guidance, was issued solely by the FDIC. The other federal regulators did not officially sign off on this document. In fact, the OTS proposed its own, separate update guidance but pulled it back after receiving comments.

Unlike the earlier joint guidance, there was no extensive discussion of the comments received and the disposition of the issues raised. The concerns raised by industry were enumerated including: involvement by boards in oversight, triggers for excessive use of overdrafts, costs and utility of contact with customers to discuss alternatives, daily limits on fees and restrictions on transaction posting order, and opt out for non-electronic transactions. Consumer groups, by contrast, supported the guidance. The FDIC simply concluded:

“After reviewing public comments, the FDIC continues to believe that there are significant reputational and safety and soundness risks associated with many overdraft payment programs.”

Then the guidance was adopted with little change. Here are the key issues and compliance challenges.

Ad Hoc v. Automated Programs

This guidance is directed at automated programs that are used to determine whether NSF transactions qualify for overdraft coverage based on pre-determined criteria. Ad hoc programs involve irregular and infrequent occasions on which an officer exercises discretion to determine whether or not to pay a specific item. Most Texas banks operate an automated program. The fact that checks that exceed the pre-set overdraft “privilege” or “courtesy” balance may be paid on an ad hoc basis will not render that program an ad hoc one.

Board Oversight

As part of the overall compliance function, boards of directors are required to provide “appropriate” oversight of these programs. There should be “ongoing and regular” oversight of features and operation. This includes, at a minimum, an annual review of the program’s key features.
Recommendation: The board should receive monthly (or at least quarterly) reports on the overdraft protection program (ODP), including “best practices” compliance, usage statistics, opt in/opt out data, as well as fee income and consumer complaints along with their resolution. This report should be developed by a “compliance review committee” as authorized under Section 59.009 Texas Finance Code. Reports from such a Compliance Review Committee are not discoverable in litigation. Be sure that the Compliance Review Committee’s purpose is to test, review or evaluate the bank’s conduct, transactions, or potential transactions for compliance with legal requirements as well as compliance with bank policies and safe, sound, and fair lending practices.

Once a year, the board should review the program’s parameters to determine whether the criteria for coverage, fees, and other key components should be adjusted. The board minutes should reflect the action taken and the fact that the reviews were undertaken.

Marketing and Disclosures

The guidance requires that marketing, disclosure and implementation should minimize potential consumer confusion and “promote responsible use.” Banks should be mindful of the potential for Unfair or Deceptive Acts or Practices (UDAP) violations if marketing materials are misleading. In addition, all advertising should comply with the disclosure requirements specifically mandated in Regulation DD, 12 CFR 330.11.

OCC Bulletin 2010-15 provides further insights as to what is meant by UDAP concerns with regard to ODP. In particular, communications should not contain misleading representations or omissions about:

- Types of transactions affected by opting in (or failing to do so)
- Consequences of opting in or failing to do so
- Fees that may be incurred.

Scare tactics should not be used in persuading customers to opt in to debit card transaction coverage.
Recommendation: Be sure that all marketing pieces, including scripts for radio and TV as well as print ads, are reviewed by compliance department or counsel to assure conformity with Regulation DD and UDAP. Be clear that the coverage is discretionary. Avoid terms that would imply that payment is guaranteed. Terms like “inadvertent” and “occasional” for usage would be preferable. Use model forms for opt in to debit card coverage.

Train Staff

Be sure that front line employees can explain program features and explain other choices, such as sweeps between accounts to cover inadvertent overdrafts.

Recommendation: Develop power point or other training material for customer service reps and new accounts staff to make sure that they correctly describe ODP.

Balance Disclosures

Don’t include “overdraft privilege” amount in balances when consumers make balance inquiry.

Recommendation: Be sure that ATMs and voice response as well as online banking programs disclose actual balance rather than balance plus overdraft privilege. Contact data processor to make sure this is correctly handled.

Monitor

The FDIC guidance indicates that banks should monitor programs for “excessive or chronic” customer usage. However, it then indicates that six occasions (where a fee is charged) in a twelve-month period would require the bank to undertake meaningful and effective follow-up action. Then the guidance provides “examples” for following up, such as contacting the customer (for example in person or by phone) to “discuss” less costly alternatives like a linked savings account, more reasonably priced line of credit or safe and affordable small dollar loan and then giving the customer a “reasonable opportunity” to decide to continue with ODP or choose another “available” alternative.

The guidance notes that the line of credit should be consistent with “safe and sound” banking practices.

Concerns: This part of the guidance is the most troubling, the most expensive, and the most ambiguous. It was hotly opposed by the banking industry but was not changed. It appears to be taken from a bill introduced into Congress by Rep. Maloney that did not pass.
The initial question is whether six transactions in a twelve-month period is “excessive.” Banks need to review the metrics of their particular program to determine usage patterns by consumers.

Furthermore, since there is a “rolling” twelve-month period, it appears that the bank would have to have a perpetual counseling program for consumers who regularly use the ODP.

Next, it is arguable that there are other “meaningful and effective” ways to follow up rather than by calling the customer. This could include a statement stuffer using an educational brochure like the one developed by the Fed or consumer tips material developed by the FDIC.

Attempting to contact consumers by telephone has many problems. First, consumers who are under economic stress (e.g. and thus are overdrawing their account) are not likely to return calls from bankers and may screen calls out of fear. Second, banks may not have good phone numbers for customers. Although cell phone numbers are transferrable, it is still possible that some consumers may change their phones frequently without keeping the same number and without informing the bank of the change. Next, the time required to make contact and then “counsel” consumers is significant. Furthermore, the consumer may not qualify for a line of credit or small loan and may not have a savings account to link with his checking account.

**Recommendation:** Review the bank’s own ODP metrics to identify patterns of usage. Establish a reasonable base line for “excessive” usage after reviewing realistic patterns of behavior. Use Fed or FDIC material as a statement stuffer to educate customers about alternatives and about how to responsibly manage their account (including how to reconcile their statement and monitor their balance).

### Daily Limits

Banks should limit the cost of ODP to consumers. Two examples are provided as ways that this can be done. The number of transactions that trigger a fee per day could be limited. Alternatively, there could be a dollar cap on total fees per day. This should be identical unless the bank is charging interest on the overdraft balance or has fees in addition to the NSF charge (which is true for out of state banks).

**Recommendation:** Review program metrics to determine typical daily usage. What is the average per day? The mean? The highest number should not be used! Also engage in “secret shopping” and determine what caps are being used by competitors.
De Minimis Overdrafts

Banks should “consider” eliminating fees for transactions that overdraw the account by a “de minimis” amount.

The amendments to Regulation E that require a consumer to opt in before ATM and everyday debit card transactions are covered just took effect this summer. It is likely that consumers will now be more aware of the potential for a small debit card transaction (e.g. at a fast food restaurant or coffee shop) to overdraw their account. Also, the posting order recommendation (to be discussed later in this paper) is also likely to reduce the number of small transactions that trigger overdraft fees. Therefore, this recommendation, which uses the word “consider,” may not be very significant.

Recommendation: Review program usage and “secret shop” competitors. Determine an appropriate de minimis level for transactions that would not trigger a fee. This level might be $5 or $10, for example. Make it relevant to your bank.

Balance Messages

Banks should “consider” deploying technology to provide consumers with balance information.

Recommendation: Research the capability of your online program to manage this function. For example, a consumer might establish a threshold for balance anxiety (say, $100). Then the online banking program would send an e-mail to the consumer indicating that she should log on to the bank’s web site for an important message. If the low balance information is to be delivered via e-mail, be sure that only secure e-mail is used to avoid security concerns.

In addition, if the bank has mobile banking services, then explore a mobile banking application that would send the consumer a text message when the consumer’s balance reached a pre-set level. Be sure that your agreement includes clear prior consent for such messages and discloses that the phone service provider may charge a separate fee for text messages.

Determine whether the bank will charge a fee for such messages and if so, how much. Be sure that this is reflected in your fee schedule. According to the commentary to Regulation DD, 230.8 comment 4, online banking service fee and balance inquiry fees are not the sort of fees that are “maintenance or activity fees” and would not render an account no longer “free.” However, fees to transfer funds are specifically listed as maintenance fees and would affect “free accounts.”
**Financial Literacy Counseling**

Again, the word “consider” is used. Banks should consider providing info to consumers about free or low cost workshops or individualized counseling to learn how to manage their finances.

Recommendation: Identify financial literacy resources in your community. Local school districts and community colleges may have such programs in the evening. There may be free community-based counseling services. For customers’ whose ODP is terminated due to failure to maintain their account in “good standing,” consider providing the customer with a list of counseling and education resources.

**Check Clearing**

This section of the guidance is written in mandatory language. Banks must “ensure” that their operations avoid maximizing overdrafts and fees through the clearing order. “Appropriate” procedures for clearing would include clearing items in the order received or by check number.

Concerns: This section simply does not comport with customer and bank practices. As noted in a recent Fed report, two-thirds of transactions by consumers are now debit card transactions. Fewer and fewer paper checks are written by consumers (although commercial accounts still appear to favor this form of payment). Debit card transactions are batched by merchants’ data processors. Transactions may not be submitted by the merchant until two or three days after they are preauthorized by the card issuing bank. Checks are batched and can be received throughout the banking day. Checks may be transmitted by remote deposit capture with a later cut-off hour than other items. In short, “check number” will work for only a few items, and “order received” is hard to define.

The true underlying issue is a concern that banks are manipulating the processing of items in order by commingling checks and electronic items and then paying the largest items first. This is likely to result in fewer items being paid with more fees generated by more, small items (like debit card transactions) paid as overdrafts.

The changes in Regulation E requiring a bank to receive an affirmative opt in before it can charge a consumer a fee for ATM and everyday debit card transactions should have (1) educated consumers about the potential cost and (2) resulted in clear choices by informed consumers.

Meanwhile, class action lawsuits against large banks with regard to their overdraft practices have been based in part on their processing practices. With a trial court decision in California
against Wells Fargo decrying commingling and payment of largest first, there is a strong business reason to revisit order of posting.

Recommendation: Do not commingle transaction types! Consider posting so that “must pay” items are paid first, with cash transactions posted first, then wires, then debit card transactions, and then check and ACH transactions. Within transaction codes, consider paying smallest to largest on each category except checks and ACH. The judge in the Wells Fargo case used that sequencing but permitted payment of checks and ACH largest to smallest.

Communicate with your data processor to determine what options are available to you and whether you would need special programming to make desired changes.

Monitor and Mitigate Risks

The guidance has a catch-all provision that requires banks to monitor and mitigate credit, legal, reputational, safety and soundness, and other risks. The legal risks include compliance with UDAP, fair lending, Truth in Savings Act and Electronic Fund Transfer Act. Thus, the specific requirements in Regulation DD relating to disclosures of overdraft programs and periodic statement requirements as well as the Regulation E requirement for specific opt in of coverage of ATM and everyday debit card transactions must be satisfied.

Recommendation: Using the Compliance Review Committee, review the program parameters and disclosures for regulatory compliance. Review fee structure not only for these rules but also to determine whether the fees could be considered “unfair” and thus a violation of UDAP. Excessive fees and posting systems that are considered unfair could also engender reputational risk. Evaluate these not only for compliance with the standards itemized above but also for perceived “fairness.”

Steering

Banks are reminded to comply with Regulation E with regard to providing notice to consumers and an opportunity to opt in to coverage of debit cards and ATM transactions with regard to ODP. The FDIC expresses concerns that consumers who are least able to afford ODP fees may be “steered” into the program. Further, the FDIC specifically suggests that aggressive marketing campaigns might raise safety and soundness concerns about unsustainable debt (and thus losses in this “credit” portfolio). In addition to the risk to the bank, the FDIC is concerned that these campaigns might violate UDAP and fair lending laws.
Recommendation: Banks should fully comply with the Regulation E requirements for opt in to ATM and debit card coverage through ODP. Use the Fed’s model notice and be sure to identify available alternatives to ODP. To limit the “steering” allegations, be sure that sweeps between accounts and open end credit options are available and offered to consumers. The open-end credit option can and should have sound underwriting requirements and meet all the requirements of Regulation Z as well as state law requirements (Chapter 346 Texas Finance Code).

**Opt out – Checks**

Although the current regulatory scheme only provides for “opt in” for ATM and everyday debit card transactions, the FDIC believes that banks should allow customers to opt out of check and ACH transactions. This suggestion was included in the 2005 Best Practices. Presumably, it was superseded by the rules change. Remember, too, that Regulation E provides that consumers may revoke their “opt in” decision at any time. Thus, arguably this provision goes too far.

Recommendation: Add an “opt out” procedure for other items. There are two different levels at which this could be achieved. The simplest method is to honor a request by a consumer to terminate their ODP coverage for checks and ACH. Be sure that your data processing system is set up to handle this choice.

The more complete approach would be to offer customers a choice at account opening. At that point, consumers could decide to “opt out” of (1) all ODP coverage or (2) only checks and ACH. Then consumers would need to make a separate, independent decision to opt in to ATM and debit card transaction coverage.

The FDIC urges banks to remind consumers, especially those who are heavy users of ODP, that they can opt out at any time. Consider developing a statement stuffer with that message. Be sure that your web page discussion of ODP includes the opt out alternatives.

**Vendor Due Diligence**

If the bank is using a third party vendor for its ODP, then it must perform initial and ongoing due diligence on the vendor.

Recommendation: Be sure that the bank is in compliance with the 2008 Guidance for Managing Third-Party Risk.
Fair Lending

Both the 2005 guidance and the recent FDIC guidance remind bankers of the risk of fair lending violations. These could occur either through steering members of a protected class into the ODP product rather than presenting other alternatives and through waiving NSF fees in a discriminatory fashion.

Recommendation: Either avoid the risk of a fair lending violation by never waiving NSF fees or be sure that such waivers are supported by an independent, documented business reason. Do not waive such fees for insiders (directors, executive officers, or principal shareholders).

Conclusion

The FDIC guidance is effective July 1, 2011. IBAT will be working with the FDIC to try to refine this guidance, clarifying certain areas and hopefully eliminating recommendations that are too costly. Consumers have been given clear notices and opportunity to choose ODP based on very recent changes to federal regs. Those revised rules should be given time to work.

Meanwhile, however, it is prudent to update policies and procedures where possible and to begin working with data processors for potential changes. Although the guidance arguably only applies to state nonmember banks regulated by the FDIC, the OCC appears to be also applying it. Further, the new Bureau of Consumer Financial Protection is likely to implement similar—or more onerous—provisions. In short, plan for increased compliance costs and reduced revenue.