Supplemental Information

Background

As highlighted by the FDIC's November 2008 *Study of Bank Overdraft Programs*, institutions continue to expand the types of overdraft payment programs provided to consumers. With changes in technology, the range of services and number of transactions potentially causing an overdraft has broadened to include not only paper checks, but also ATM machines, point-of-sale (POS) debit card use, preauthorized debits, telephonic fund transfers, and online banking transactions. Program participation has sometimes been based on automatic enrollment, and customers may not have fully understood the risks and potential costs involved.

Overdraft fees can exceed the amount of the overdraft and can occur multiple times in a single banking day, depending on the type and amount of transactions and the transaction-clearing practices of the institution. For example, batch processing checks and clearing them from largest to smallest likely increases the number of items triggering an overdraft.

Extremely high costs in relationship to the overdraft benefit and/or permitting product over-use often result in customer dissatisfaction and complaints. Serious financial harm can result for customers with a low or fixed income.

Supervisory Expectations

The FDIC expects institutions to implement effective compliance and risk management systems, policies, and procedures to ensure that institutions manage any overdraft payment programs in accordance with the attached 2005 *Joint Guidance on Overdraft Protection Programs* [1] (*Joint Guidance*) (FIL-11-2005) and the Federal Reserve Board's (FRB) November 12, 2009 amendments to Regulation E, to avoid harming consumers or creating compliance, operational, financial, reputational or other risks. As changes are made in overdraft payment programs in response to regulatory developments or to implement additional recommendations, institutions are reminded to ensure that customer communications (*e.g.*, agreements, correspondence, marketing materials, etc.) are updated accordingly, present information accurately and are not misleading.

The FDIC is particularly concerned about the risks posed by automated overdraft payment programs. Ad hoc overdraft payments[2] made as an accommodation are not the focus of this guidance, nor are linked lines of credit; however, management should ensure that these practices conform to all applicable laws and regulations, including Regulation Z with respect to lines of credit. To mitigate safety and soundness and compliance risks, and avoid violations of related laws and regulations, the FDIC expects its supervised institutions to take the following actions regarding automated overdraft payment programs:

- Ensure ongoing and regular board and management oversight of program features and operation. Appropriate steps include an annual review of an overdraft program's features.

- Review their marketing, disclosure, and implementation of such programs to minimize potential consumer confusion and promote responsible use.

- Train staff to explain program features and other choices.

- Prominently distinguish account balances from any available overdraft coverage amounts. Note also that, as of January 1, 2010, Regulation DD (Truth in Savings Act) prohibits institutions from including overdraft coverage amounts in any account balance information provided by an automated system.[3]

- Monitor programs for excessive or chronic customer use, and if a customer overdraws his or her account on more than six occasions where a fee is charged in a rolling twelve-month period, undertake meaningful and effective follow-up action, including, for example:

    - Contacting the customer (*e.g.*, in person or via telephone) to discuss less costly alternatives to the automated overdraft payment program such as a linked savings account, a more reasonably priced line of credit consistent with safe and sound banking practices, or a safe and affordable small-dollar loan;[4] and

    - Giving the customer a reasonable opportunity to decide whether to continue fee-based overdraft coverage or choose another available alternative.

    - The FDIC specifically seeks comment on whether an effective way to monitor for excessive use of automated overdraft programs would be for supervised institutions to contact a customer after the six transaction fees trigger and discuss available alternatives. The bank would explain, for example, that it also offers linked savings accounts, overdraft lines of credit or small dollar loans, each of which may be less expensive than the automated overdraft program. The consumer would then be asked to pick the available option he or she prefers to cover any future overdrafts, including the choice of opting in to the bank's overdraft program.

- Institute appropriate daily limits on customer costs by, for example, limiting the number of transactions that will be subject to a fee or providing a dollar limit on the total fees that will be imposed per day.

- Consider providing information to consumers about how to access free or low-cost financial education workshops or individualized counseling to learn how to more effectively manage personal finances. If an institution's community-based partners do not already provide counseling, the Federal Trade Commission's (FTC) *Choosing a Credit Counselor*[5] may be one resource to help institutions choose quality credit counseling partners.

- Review check-clearing procedures to ensure they operate in a manner that avoids maximizing customer overdrafts and related fees through the clearing order. Examples of appropriate procedures include clearing items in the order received or by check number.

- Monitor and, where necessary, mitigate credit, legal, reputational, safety and soundness, and other risks, as appropriate. Legal and compliance risks associated with the overdraft payment programs include: Section 5 of the Federal Trade Commission Act, the Equal Credit Opportunity Act, the Truth in Savings Act, the Electronic Fund Transfer Act, as well as related implementing regulations and any changes to those regulations or statutes.

Regulation E Requirements

Under new Regulation E requirements that took effect on July 1, 2010, institutions must provide notice and a reasonable opportunity for customers to opt in to the payment of ATM and POS overdrafts for a fee. In complying with these requirements, institutions should not attempt to steer frequent users of fee-based overdraft products to opt in to these programs while obscuring the availability of alternatives. Targeting customers who may be least able to afford such products can raise safety and soundness concerns about potentially unsustainable consumer debt. Any steering activity with respect to credit products raises potential legal issues, including fair lending, and concerns about unfair or deceptive acts or practices (UDAPs), among others, and will be closely scrutinized.

Although the FRB did not address the payment of overdrafts resulting from non-electronic transactions, such as paper checks or ACH transfers, the FDIC believes institutions should allow customers to decline overdraft coverage (*i.e.*, opt out) for these transactions and honor an opt-out request.[6]

Examinations

Overdraft payment programs will be reviewed at each examination. Overdraft payment programs that are found to pose unacceptable safety and soundness or compliance risks will be factored into examination ratings and corrective actions will be taken where necessary. Institutions that use third party arrangements will be expected to follow the attached 2008 *Guidance for Managing Third-Party Risk.*

Institutions should review the FDIC's 2004 guidance (issued jointly with the FRB) on *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (FIL 26-2004). Section 5 of the FTC Act prohibits UDAPs in or affecting commerce,[7] and the FDIC enforces compliance with this important consumer protection law by FDIC-supervised institutions pursuant to its authority in the FTC Act and section 8 of the Federal Deposit Insurance Act.[8]

The prohibition against UDAPs applies to all products and services offered by financial institutions, including automated overdraft payment programs, and regardless of whether such programs are offered directly or indirectly through a third party.

In addition, as stated in the *Joint Guidance*:

"Under the Equal Credit Opportunity Act (ECOA) and Regulation B, creditors are prohibited from discriminating against an applicant on a prohibited basis in any aspect of a credit transaction. This prohibition applies to overdraft protection programs. Thus, steering or targeting certain consumers on a prohibited basis for overdraft protection programs while offering other consumers overdraft lines of credit or other more favorable credit products or overdraft services, will raise concerns under the ECOA."

Inconsistent application of waivers of overdraft fees will be evaluated in light of all applicable fair lending statutes and regulations.

Institutions will continue to receive favorable CRA consideration for offering positive alternatives to overdrafts that are responsive to the needs of the customers in their local communities. For example, FDIC examiners will inquire about and consider favorably lower cost transaction accounts and credit alternatives, such as small dollar loans and overdraft lines of credit, which are responsive to consumer needs, particularly those of low- and moderate-income individuals. FIL-50-2007[9] provides additional details on small-dollar loans.

COMMENTS REQUESTED: Institutions and other parties that choose to respond should provide comments **no later than September 27, 2010. Responses should be submitted via e-mail to OverdraftComments@fdic.gov or via fax to** (703) 465-4303**.** All comments received will be posted generally without change to http://www.fdic.gov/regulations/laws/PublicComments/comments_overdraft.html, including any personal information provided.

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[1] 70 *Fed. Reg.* 9127 (Feb. 24, 2005).

[2] In contrast to automated overdraft payment programs, ad hoc overdraft payments typically involve irregular and infrequent occasions on which a bank employee exercises discretion in a specific instance about whether to pay an item or not.

[3] 12 C.R.R. § 230.11(c). Institutions may, but are not required to, provide a second account balance that does include overdraft coverage amounts if the distinction between the two is prominently stated. *Id.*

[4] *See A Template for Success: The FDIC's Small-Dollar Loan Pilot Program* which provides a template for safe and affordable small-dollar loans (http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_2/smalldollar.html)

[5] http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre26.shtm.

[6] Revised Regulation E provides consumers with an ongoing right to rescind their prior opt-in to coverage of ATM and POS overdrafts.

[7] 15 U.S.C. § 45(a).

[8] *See* 12 U.S.C. § 1818(b).

[9] http://www.fdic.gov/news/news/financial/2007/fil07050.html