Delivering expert knowledge
to global counsel

International Law Office®

Banking - USA

Frequently asked questions and answers on overdraft payment programmes

Contributed by Sidley Austin LLP

May 06 2011

Authors

David Teitelbaum

Susan White Haag

Introduction

The Federal Deposit Insurance Corporation (FDIC) recently issued frequently asked questions (FAQs) and answers in response to questions from FDIC-supervised institutions and third-party vendors about the FDIC's Overdraft Payment Supervisory Guidance issued in November 2010.(1) The FAQs provide further explanation of the FDIC's supervisory expectations regarding overdraft payment programmes. The FAQs state that the FDIC expects institutions to have internally approved and "responsive" compliance and risk management action plans, policies and procedures for overdraft programmes in place by July 1 2011.

Background

In November 2009 the Board of Governors of the Federal Reserve System issued rules prohibiting financial institutions from charging consumers fees for paying overdrafts on automated teller machine and one-off debit card transactions, unless the consumer consents, or opts in, to the overdraft service.(2) In November 2010 the FDIC issued the Overdraft Payment Programme Supervisory Guidance, which created significant industry concern because of the additional requirements it imposed beyond the board's regulation.(3) Among other things, the guidance requires institutions to:

- promptly honour consumer requests to opt out of overdraft coverage for non-electronic transactions;
- give consumers the opportunity to choose affirmatively among available overdraft payment products;
- monitor accounts and take "meaningful and effective action" to limit use by customers of overdraft payments as a form of short-term, high-cost credit;
- institute daily limits on overdraft fees and consider eliminating overdraft fees for transactions that overdraw an account by a *de minimis* amount;
- not process transactions in a manner designed to maximise the cost to consumers; and
- monitor and, where necessary, mitigate credit, legal, reputational, safety and soundness, and other risks associated with overdraft payment programmes.

Frequently asked questions

In response to industry concerns raised by the guidance, the FDIC conducted a teleconference on March 29 2011, and thereafter issued FAQs and answers. Unfortunately, many industry concerns regarding the FDIC's expansion of compliance obligations with respect to overdraft programmes remain unanswered by the FAQs. Highlights of the FAQs are set out below.

Excessive use and meaningful follow-up
The guidance states that FDIC-supervised institutions should monitor programmes 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 12-month period, the institution is to undertake "meaningful and effective follow-up action".

Excessive use
The FAQs provide that an 'occasion' for the purposes of determining excessive or chronic customer use occurs each time that an overdraft transaction generates a fee. For example, an occasion would include a per-transaction overdraft fee or a daily fee for

an outstanding overdraft status. As a result, more than one occasion can occur per day. Overdraft items paid where no fee is charged would not be included, such as where a bank pays an item after a daily limit is met on overdraft items paid and the bank waives additional fees.

Meaningful and effective follow-up
The FAQs provide two examples of "meaningful and effective follow-up" for excessive or chronic users of overdraft programmes:

- providing enhanced periodic statements; or
- employing a targeted outreach approach*.*

An enhanced periodic statement approach would involve augmenting existing overdraft fee disclosures required under Regulation DD (Truth in Savings), which requires disclosure of the total amounts of fees charged for overdrafts during the statement period and calendar year to date, by "prominently highlighting" how excessive or chronic users of automated overdraft programmes could contact the institution to discuss available alternatives and "encouraging meaningful and effective contact". A targeted outreach approach could involve contacting excessive users in person or via telephone to discuss less costly alternatives to automated overdraft payment programmes.

Fee limits and maximising fees
Daily limits
The guidance recommends that an institution impose daily limits on overdraft fees. The FAQs provide examples of appropriate daily limits, including limits on the number of transactions per day that will be subject to a fee or a total maximum dollar amount of allowable fees per day.

De minimis *overdraft amounts*
The guidance and the FAQs state that institutions should also consider the use of a *de minimis* threshold before an overdraft fee is charged. For example, the FAQs state that some institutions have implemented *de minimis* limits whereby they do not charge overdraft fees for underlying transaction amounts of less than $10, while some have declined to charge overdraft fees for transactions of any amount that overdraw an account by less than $10.

Reasonable and proportional overdraft fee
Noting that institutions may increase reputational risk when overdraft fees are significantly greater than the amount of the item being cleared, the FAQs state that institutions should review the amount charged for an overdraft payment compared to the amount of the underlying transaction that triggered the overdraft, and assess whether the charge is reasonable and proportionate in comparison. Institutions should also consider *de minimis* limits to reduce the reputational risk of overdraft fees that are disproportionate to the cost of the underlying transaction.

Processing transactions
The FAQs state that transactions should be processed in a neutral order that avoids manipulating or structuring processing order to maximise customer overdraft and related fees. Examples of a neutral order include order received, cheque number, serial number sequence or other approaches when necessary, based on sound business justification. Re-ordering transactions to clear the highest item first is not considered neutral because this approach will tend to increase the number of overdraft fees. By contrast, processing batches of transactions in a random order or order received is a neutral approach; however, institutions should not arrange the order of types of transaction (ie, batches) cleared in order to increase the number of overdrafts and maximise fees.

Other questions and answers
Other salient points addressed in the FAQs include the following:

- Only 'automated' overdraft programmes that do not involve individual employee judgements about specific items are covered.
- Banks are not required to develop new products in response to the guidance.
- An institution is not expected to terminate or suspend a customer's access to an automated overdraft payment programme if the customer engages in chronic or excessive use. However, institutions are supposed to monitor usage and follow-up to inform excessive users of available alternatives. To the extent that risks associated with chronic or excessive use are identified (eg, reputational, compliance, safety-and-soundness or litigation risks), the FDIC states that institutions "should take appropriate action to mitigate risks".
- To promote consumer choice and awareness, institutions are encouraged to permit customers to decline overdraft coverage (ie, opt out) for transactions that are not subject to Regulation E opt-in requirements, including cheques, automated clearing house transactions and recurring debits. As part of an institution's ongoing relationship with customers, the FDIC recommends that institutions consider

occasional communications to remind customers of available options to terminate overdraft coverage.

For further information on this topic please contact David Teitelbaum *or* Susan White Haag *at Sidley Austin LLP by telephone (+1 202 736 8600), fax (+1 202 736 8711) or email (*dteitelbaum@sidley.com *or* shaag@sidley.com*).*

Endnotes

(1) See FDIC Overdraft Payment Programme Supervisory Guidance FAQs, available at www.fdic.gov/news/conferences/overdraft/FAQ.html.

(2) See 12 CFR § 205.17 (Regulation E); see also 12 CFR § 230.11 (periodic statement and advertising disclosures for overdraft services) (Regulation DD).

(3) See FIL-81-2010 (November 24 2010).