



# Overdrafts – The Good, the Bad & the Ugly

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# Overdrafts – The ~~Good~~, the Bad & the Ugly

- This session will address:
  - Historical Perspective on Overdrafts
  - Regulation E and Overdrafts
  - New FDIC “Guidance”
  - Recent Litigation & Enforcement Actions
  - What does all this mean?

# Overdrafts – The Good, the Bad & the Ugly

- What we aren't talking about -
  - Overdraft Lines of Credit
    - Must meet underwriting standards
    - Subject to Truth in Lending Act & Regulation Z
    - Execute loan documents
    - Pay a set rate of interest on the loan amount
  - Dynamic Transfers
    - Checking account is linked to savings account and funds will be pulled from the savings account to cover the overdraft
    - Typically a flat fee

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# **HISTORICAL PERSPECTIVE**

# Overdraft Privilege Programs Defined

- “Overdraft Privilege Programs” or “Bounce Protection”
  - Financial institution has the **discretion** to pay (or return unpaid) any item presented against an account when the account lacks sufficient funds to cover the item
  - Flat fee (varies - \$30-35 common) per overdraft

# Historical Perspective

- When was the first overdraft granted?
- What bank was the first to

# Historical Perspective

- As early as 1728 the Royal Bank of Scotland started allowing overdrafts
- Started off as financial institutions paying a check when a customer's account lacked the funds to cover a check;
- No fee originally associated with this;
- Many financial institutions charge a returned item fee which is the SAME as their courtesy pay fee.
- Evolved to cover electronic payments in addition to traditional paper checks.

# Historical Perspective

- FDIC conducted a study in 2006 to collect empirical data on the types, characteristics, and use of overdraft programs  
(<http://www.fdic.gov/bank/analytical/overdraft/>)
- Roughly 74% of bank customers never have an NSF fee
- Of those who HAVE NSF fees, 68% have 20 or more in a year

# Historical Perspective

- Governing laws/regulations:
  - 2005 “Guidance”
  - Truth in Savings Act & Regulation DD 12 CFR 230.11
  - Electronic Funds Transfer Act & Regulation E
- Not governed by Truth in Lending & Regulation Z
  - Overdraft privilege programs are ***discretionary***

# Historical Perspective

- 2005 Guidance:
  - Joint Agency Guidance – included credit unions
  - Addressed safety and soundness considerations including a 60-day charge-off period, adopting appropriate policies, and Call Report requirements

# Historical Perspective

- 2005 Guidance:
  - Addressed key legal issues, including compliance with certain federal laws as they pertain to overdraft protection programs.
  - Included a variety of best practices currently found to be in use or recommended including marketing and communications that accompany the offering of overdraft protection services, as well as disclosures and operations of program features

# Historical Perspective

- H.R. 3904: Overdraft Protection Act of 2009
- S. 1799: FAIR Overdraft Coverage Act
- H.R. 1487: Overdraft Fee Notification Act
- H.R. 1456: Consumer Overdraft Protection Fair Practices Act
- Dead but not forgotten?

# Historical Perspective

- Truth In Savings Act & Regulation DD
- 12 CFR 230.111
- Additional disclosure requirements for overdraft services
- Monthly statement requirements
- Advertising requirements
- ATM balances must disclose when overdraft program as included in the balance

# Historical Perspective – Consumer Advocate Concerns

- Why is this an issue?
- Consumer Advocates – nothing but a payday loan
- Financial Institutions not telling customers about lower cost options
- Collections / credit score issues if not repaid

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# **REGULATION E & OVERDRAFTS**

# Regulation E & Overdrafts

- Electronic Funds Transfer Act
  - 15 USC 1693
- Regulation E – 12 CFR 205
- Overdraft change effective July 1, 2010 for new account holders and August 15, 2010 for accounts existing before July 1, 2010.
- Opt-in requirement before a financial institution can pay an *electronic overdraft* **AND** charge a fee.

# Regulation E & Overdrafts

- Opt-in Requirement Scope:
  - Only applies to transactions within the scope of Reg E – consumer accounts ONLY
  - Debit card & ATM transactions
- Does not apply to ACH transactions or checks (including checks clearing under Check 21)
- Required significant systems changes (& internal procedural changes at financial institutions)

# Regulation E & Overdrafts

- Opt-in very difficult, if not impossible to do “on the fly”
- Opt-in may be verbal or written under the Regulation
- Opt-in must be confirmed in writing
- Consumer may change their decision at any time and Financial Institutions must have an opt-out option as convenient as the opt-in option

# Regulation E & Overdrafts

- Results of this change?
  - Yes, income to financial institutions does appear to be down;
  - “Frequent Flyers” seemed to have opted in.

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**FIL 81-2010  
OVERDRAFT  
GUIDANCE**

# FIL-81-2010 - Purpose/Scope

- Issued by the FDIC on 11/24/2010
- Incorporates 2005 Joint Guidance on Overdraft Programs
- Expresses concerns posed by “automated overdraft programs”
- Focuses on financial institution risk mitigation in relation to the service
- FDIC Q and A clarifies some concerns

# FIL-81-2010 - Content

- Risk Mitigation based on an institutions particular business may include:
  - Monitoring for chronic or excessive use
  - Counseling consumer
  - Determining appropriate fees
  - Unfair and Deceptive Acts and Practices
  - Opt Out
  - Transaction Processing

# FIL-81-2010 - Excessive or Chronic Use

- Should monitor for “excessive or chronic users”
  - Defined as 6 occurrences in a rolling 12 months basis
  - FDIC Q and A indicates that an occurrence is anytime a fee is charged as a result of an overdraft. Sustained fees would count!
- Systems may need to be modified in order to effectively track on a rolling basis

# FIL-81-2010 - Counseling

- FDIC Q & A
  - No prescribed method of counseling
- Key is to have a program
  - “to inform excessive or chronic users of overdraft usage and cumulative costs in a prominent or conspicuous fashion”;
  - Highlight alternatives that may be lower cost; and
  - Provide a clear and easy way for the customer to contact the bank about alternatives.

# FIL-81-2010 - Counseling

- FDIC specifically mentions two (2) alternatives
  - Targeted outreach approach
    - Directly contact customers that are excessive or chronic users within a “reasonable time”
    - Continued contact if the cycle continues **unless the customer indicates they no longer want to be contacted.**
  - Enhanced periodic statements
    - This would involve an institution including a message on the customers statement giving them a number where they could contact the institution to discuss alternatives.
    - Continue as the cycle of chronic use continues.
    - Includes “sample language.”

# FIL-81-2010 - Fees

- Fees should be “reasonable.”
- Should look at your particular institution and justify:
  - That fees are proportionate to the underlying overdrafts.
  - May include waiving “de minimis” fees.
  - May include limiting fees by transaction or dollar amount.

# FIL-81-2010 - UDAP

- UDAP is always an overarching concern
- Guidance emphasizes Agency ability to use UDAP authority to penalize a financial institution for overdraft “abuses”
- Legal/Compliance Review of all marketing or consumer correspondence
- Ensure that all triggers, fees, and alternatives are clearly disclosed!!

# FIL-81-2010 - Opt Out

- Guidance discusses Opt Out in 2 different areas
- Suggests offering opt out to “excessive or chronic users” as well as offering opt out to all customers for any overdraft vehicle not covered by Regulation E
- Encourage financial institutions to communicate with customers alternative options.

# FIL-81-2010 - Opt Out

- Unintended consequences?
  - If the consumer opts out of the program and a financial institution cannot charge a fee will they be more apt to return the check?
  - Consumer may be faced with 2 charges instead of 1 (bank for returned check and merchant for the returned item)
- Competitive disadvantage since this is FDIC specific guidance?

# FIL-81-2010 - Transaction Processing

- Guidance makes clear that high to low transaction processing is detrimental to consumers and *should* not be used
  - Focus on “neutral processing order”
  - Provide evidence that a consumer prefers high to low?
- Recent court cases seem to be driving this issue.

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# **RECENT LITIGATION & ENFORCEMENT ACTIONS**

# Gutierrez v Wells Fargo

- Plaintiff alleged violation of State unfair and deceptive law
- Primary allegation centered around high to low transaction processing
  - The practice of “shadow” lines and comingling of transaction types were also taken into consideration.
- Court found that there was no evidence that high to low processing benefited consumers

# Recent Litigation & Enforcement Actions

- Gutierrez v Wells Fargo
- Woodforest Bank – OTS Settlement
- Woodforest National Bank – OCC Enforcement Action
- Miller vs. Bank of America

# Gutierrez v Wells Fargo

- Internal memos seemed to indicate that overdraft revenue was at core of processing strategy
- Court decision was also focused on ACH transactions where the bank (under most circumstances) have to pay
- The Guidance seems to take the courts opinion and apply it to a broader set of circumstances

# Gutierrez v Wells Fargo

- The Guidance extends the ruling of Gutierrez to cover all financial institutions disregarding the specific facts that led to the courts decision
- Question whether the decision would have been different had the program been more clearly explained to the consumer either at account opening or throughout the process?

# Woodforest Bank

- Office of Thrift Supervision Settlement –  
Issue Date: 04/23/2010  
Order Number: WN 10-17 & WN 10-16
- Woodforest to pay \$400,000 penalty and roughly \$12 million in consumer restitution for excessive overdraft fees
- Woodforest is a thrift institution based in Refugio, Texas, with **\$85.9 million** in total assets
- Order focuses on safety & soundness considerations (mentions UDAP)

# Woodforest National Bank

- Office of the Comptroller of the Currency (“OCC”) enforcement action
- #2010-202 October 1, 2010
- Civil monetary penalty of \$1,000,000 plus \$32 million in consumer restitution (\$1.8 billion in assets)
- UDAP violation & Reg E violation (conditioning credit on repayment by preauthorized electronic fund transfers)

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Questions?

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