ABA Staff Analysis: OTS proposed supplement to Overdraft Guidance
April 2010

On April 23, 2010, the OTS released for comment a proposed supplemental guidance on overdraft protection to update its Overdraft Guidance issued in February 2005. It says the proposal is designed to "complement rather than replace" the 2005 Overdraft Guidance, and encourages institutions to review overdraft programs to confirm that they are operated in a manner that is "effective, compliant with the law, and fair to consumers."

In effect, the OTS is proposing to equate unfair or deceptive practices with failure to follow some of its "best practices." Much of the proposal reflects a recent settlement with Woodforest Bank regarding overdraft practices. The OTS’s approach raises important issues and concerns as the proposal:

- Classifies certain practices as unfair or deceptive including:
  - Marketing accounts with overdraft protection to those with previous difficulty managing financial accounts as accounts that will help avoid future financial challenges;
  - Marketing an account or account feature as “free” without describing information about the cost of overdraft transactions;
  - Not “promptly” notifying customers of overdraft usage each time it is used; and
  - Not imposing daily limits on aggregate overdraft fees.
- Absolves customers of basic management responsibilities in some cases.
- Fails to provide meaningful or useful analysis so as to create uncertainty and legal vulnerability with regard to common practices.
- Contrary to recent trends, leans toward adding significant new disclosures that will tend to clutter disclosures and lead to information overload.
- Creates supervisory expectations at odds with the recent Federal Reserve Board rulemaking.

In addition, the OTS is soliciting comment on whether it should adopt a regulation requiring that overdraft fees be "reasonable and proportional."

Comments are due 60 days after publication in the Federal Register.

Specific Overdraft Practices:

1. Fairly represent overdraft protection programs.²

The OTS here focuses on concerns about marketing overdraft programs to those who have had difficulty managing accounts in the past and stresses that the need to review the consequences of overuse of overdraft services is heightened where associations target consumers who have experienced financial difficulties." It advises that institutions “should avoid marketing accounts covered by overdraft protection in a manner that leaves the impression that the accounts are designed to help avoid future financial challenges, especially when contrary information is omitted." The proposal continues, "For example, it would be a material misrepresentation to market an account as particularly suitable for those with prior credit or bank account problems without informing consumers of significant overdraft fees associated with an account... Failing to provide such consumers with fee information appears to significantly impair their ability to determine whether an account meets their needs." Failure to provide information about fees in these circumstances (i.e., marketing that accounts are designed to help avoid financial problems without

---

¹ Go to: http://www.ots.treas.gov/_files/482132.pdf
² Page 13

ABA staff analysis does not provide, nor is it intended to substitute for, professional legal advice.
disclosing fees) is a deceptive practice. It appears that clear disclosure of overdraft fees at account opening or in account agreements is not sufficient to inform consumer choice if marketing materials excluded mention of such fees. The proposal provides little detail about how “fees” should be disclosed and whether a disclosure about the per item fee in these cases is sufficient. In addition, it overlooks the new opt in requirement under Regulation E.

2. Provide information about alternatives when they are offered.

The proposal suggests that in addition to providing information about alternatives when informing consumers about an overdraft protection program as suggested in the current Overdraft Guidance, institutions should address “how the terms, including fees, for these services or products differ.” In addition it suggests that “an affordable small dollar term loan might serves as an alternative to fee based overdraft protection,” and references the FDIC’s small dollar loan model. The most recent FDIC report (2009) found these programs so far to be unprofitable generally.

3. Clearly explain the discretionary nature of the program.3

Regulation DD requirements to explain the discretionary nature of overdraft payments are referenced, but nothing additional is proposed.

4. Distinguish overdraft protection programs from “free” account features.4

Regulation DD prohibits institutions from promoting free accounts and overdraft protection programs in the same advertisement in a way that suggests overdraft protection is free. The proposed guidance goes further, providing:

[It] would be a material misrepresentation to use marketing that focuses on account features that are “free” or inexpensive, but omits information about the cost of each overdraft transaction. This is particularly true when consumers have been automatically enrolled in programs that charge a significant fee for each overdrawn transaction. The net impression of such marketing may be to mislead consumers acting reasonably under the circumstances to believe that the total cost of the account (including overdraft protection) is free or inexpensive and to be unaware that engaging in overdraft transactions will result in the assessment of significant overdraft fees. (Emphasis added.)

The proposal concludes that such circumstances are deceptive and violate UDAP and the OTS advertising rule.

First, it is not clear why the proposed language includes instances where customers have been “automatically enrolled” in overdraft programs as this is no longer permitted under Regulation E. Second, it is not clear whether this provision only applies to advertisements or marketing that includes information about overdraft programs or any account advertisement. Finally, the meaning of “significant” is not clear and opens the analysis to being applied to the failure to reveal NSF fees when marketing free accounts.

5. Clearly disclose program fees.5

The proposal makes references to Regulation DD requirements that periodic statements include a total dollar for all fees or charges imposed on the account for paying overdrafts.

3 Page 14
4 Page 15
5 Page 16

ABA staff analysis does not provide, nor is it intended to substitute for, professional legal advice.
6. Clarify that fees will reduce the amount of overdraft protection provided.\(^6\)

The proposal restates the current Overdraft Guidance that institutions alert consumers that overdraft fees and overdraft items will be subtracted from the overdraft protection limit disclosed. The proposal deems failure to do so to be deceptive because failure to do so might cause a consumer to proceed with a transaction on the basis that it will be covered by the overdraft protection, when in fact the transaction will be denied or the item returned. What is unclear from the proposal is whether this is different from the obligation to disclose program fees as required by Regulation DD. It is also unclear whether this explanation is required to be contained in marketing materials.

7. Demonstrate when multiple fees will be charged.\(^7\)

The current Overdraft Guidance recommends that institutions clearly disclose that more than one overdraft fee may be charged each day. The proposal provides that omitting such information is deceptive, whether or not the institution promotes overdraft protection. It is not clear from the analysis whether this explicit disclosure must be included in marketing materials.

8. Explain the impact of transaction–clearing policies.\(^8\)

The current Overdraft Guidance recommends clearly disclosing processing and clearing policies. The proposal provides that failure to do so is deceptive. Application of this conclusion would make many programs illegal as they are described today. Given that these explanations are notoriously difficult to explain “clearly” and accurately and that there has been significant litigation on the matter, compliance would be virtually impossible and would likely lead to consumer confusion.

9. Illustrate the type of transactions covered.\(^9\)

The proposal re-states the current Overdraft Guidance that disclosures make clear that overdraft fees may be imposed on ATM and other debit card transactions and the Regulation DD provision that expressly requires the disclosure.

10. Disclose account balances in a manner that distinguishes consumer funds from funds made available through overdraft protection.\(^10\)

The proposal restates the current Overdraft Guidance and Regulation DD that requires where an institution discloses balance information through an automated system, it must disclose a balance that excludes money available through a discretionary overdraft protection service, line of credit, or linked account. The OTS “continues to encourage association to make use of this approach whenever account balances are disclosed, not just when automated systems are employed.”

11. Promptly notify consumer of overdraft protection program usage each time used.\(^11\)

The current Overdraft Guidance advises institutions to promptly notify consumers of overdraft protection program usage each time used. The proposed Overdraft Guidance provides that failing to do so, “including failing to provide a consumer with the information necessary to return the account to a positive balance” is deceptive. The rationale is that consumers may be misled into believing that the balance is positive and influence their decision whether to make a deposit or proceed with a transaction that may cause an overdraft and fee. In addition, the proposal adds, “Where technologically feasible to do so, real

---

ABI staff analysis does not provide, nor is it intended to substitute for, professional legal advice.
time notification should be provided.” It is not clear whether institution must offer, for example, e-mail alerts or text or phone messages. This standard exceeds requirements under Regulations E or DD.

12. Inform consumers when access to overdraft services will be or has been reinstated after suspension.\textsuperscript{12}

The proposal adds a new provision that it is deceptive to fail to notify consumers about the circumstances in which overdraft protection may be reinstated after suspension, e.g. when a deposit clears the outstanding overdraft and fee balance, on the basis that the consumer may be led to believe that overdraft will:

[D]efinitely not be available, when in fact it is or may be available. As a result, a consumer may overlook an account without appreciating that significant overdraft fees may result. For example, a consumer may attempt a point of sale transaction believing that it will be denied without charge if sufficient funds are not available. However, if overdraft protection has been reinstated and the transaction is paid despite insufficient funds, the consumer would be charged potentially significant overdraft fees.

It appears that an initial disclosure that overdraft protection is reinstated when a deposit clears is sufficient.

Program Features and Operation

1. Provide consumer choice\textsuperscript{13}

The proposal notes the new Regulation E requirements that customers provide affirmative consent before an institution may impose an overdraft fee for an ATM or one-time debit card overdraft. The OTS recommends in the proposal that as a best practice, institutions also provide opt-in to transactions outside the scope of Regulation E’s requirement, i.e., check and ACH transactions. The proposed guidance does not state that failure to do so is unfair or deceptive. However, it does relate opt-in to ensuring an informed choice. This premise opens up the possibility that failure to have opt-in for check overdrafts impairs the consumer’s decision and is consequently deceptive or unfair.

2. Reasonably limit aggregate overdraft fees.\textsuperscript{14}

Noting that a small number of customers pay most of the overdraft fees, that the current Overdraft Guidance advises institutions consider a daily cap on overdraft fees, and that historically the OTS and its predecessor agency have said that fees charged by savings associations are to be “reasonable,” the proposal states, “In some circumstances, failure to impose a reasonable limit on aggregate overdraft fees is an unfair practice under the FTC Act.” It continues:

The risk of engaging in an unfair practice is heightened when an association fails to limit fees for consumers who frequently overdraw their accounts, and, as a result, such consumers incur substantial injury in the form of unreasonable and excessive overdraft fees. . . For example, where overdraft protection is marketed deceptively, consumers may lack the information needed to make a reasonable choice among programs. Regardless of how overdraft protection is promoted, those who frequently overdraw accounts may simply not have other options in the market, as they may have credit histories and other characteristics that prevent them from obtaining less expensive

\textsuperscript{12} Page 21
\textsuperscript{13} Page 22
\textsuperscript{14} Page 23
services. Notably young consumers and those with lower incomes tend to exhibit a pattern of recurring overdrafts and a high volume of fees.

The proposal specifically highlights two circumstances where the harm outweigh the benefit: where the “consumers’ aggregate overdraft fees” exceed:

- the average daily balance of their accounts or
- the overdraft limit on their accounts.

It appears that the proposal is referring to the “daily aggregate overdraft fees,” as, even though not qualified specifically, the earlier reference is to “daily caps.” However, the proposal does not indicate over what period the “average daily balance” is to be calculated. Assuming it the previous month’s average daily balance, for example, if the average daily balance of an account was $250, the aggregate daily overdraft fee limit is $250. Similarly, if the overdraft limit is $300, the most that could be charged in a single day is $300. The proposal notes that the OTS would not expect most institutions to reach such levels. There is no indication of why or how these standards were selected.

In addition, the proposal provides that institutions should also monitor customer usage of overdraft protection as outlined in the subsequent section. “Where use becomes excessive, associations should either limit it or offer consumers any lower cost services that may be available.”

3. Do not manipulate transaction-clearing rules.  

Noting the current Overdraft Guidance warning that posting order should not be unfair or manipulated to inflate fees, the proposal explains, “Such a situation would occur, if for example, a savings association varied its transaction-clearing rules on a daily, customer-by-customer basis in order to maximize each customer’s fees.” The OTS adds that “such fee generation not only fails to benefit the market, it suggests a lack of transparency: economically rational consumers would likely move their accounts to other institutions if they understood that their transactions were being posted in an unfair manner. Accordingly, such practices are “unfair.”

4. Monitor overdraft protection program usage.  

The proposal restates the importance of monitoring overdraft protection usage as both a safety and soundness consideration and best practice.

5. Fairly report program usage.  

The proposal notes that the current Overdraft Guidance advises savings associations against furnishing negative information to “credit” reporting agencies. However, in fact, the current guidance refers to “consumer reporting agencies,” which include not only credit reporting agencies, but also, for example, ChexSystems, a negative data base for deposit accounts. The proposal warns institutions of new rules to go into effect July 1, 2010 that will require furnishers to implement written policies and procedures regarding the accuracy and integrity of the information furnished to consumer reporting agencies. The proposal adds, “Furnishing negative information to CRAs when overdrafts are paid under the terms of an overdraft protection program may not be accurate because such information may not reflect the terms of the account or the consumer’s performance and other conduct with respect to the account.”

15 Page 25
16 Page 26
17 Page 26
Specific request for comment regarding limits on fees.¹⁸

The OTS is asking whether it should adopt standards regarding the overdraft fees similar to those adopted by Congress for credit card penalty fees. Congress amended the Truth in Lending Act to require that credit card penalty fees be “reasonable and proportional to such omission or violation.” It is not clear what the policy motivation or statutory authority for OTS to adopt a similar standard for overdraft fees.

¹⁸ Page 7

ABA staff analysis does not provide, nor is it intended to substitute for, professional legal advice.