Overdraft Program: Risk vs Reward

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October 16, 2019

Agenda

- The Indirect Lending Channel
- Identifying the Risks
- Mitigating the Risks
- Key Examiner Trends and Red Flags

Regulatory Background

Consumers need more protection:

- CFPB was born in 2010 as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act
- One of the main focuses of the CFPB and other Agencies has always been fees charged to consumers; particularly, fees surrounding overdraft payment programs
- Some consumers' use of overdraft payment programs have become chronic or obsessive
    - As a result, the Agencies expect financial institutions to attempt to provide a less costly alternative to those consumers

Overdraft programs can be a valuable service for consumers and serve as a revenue stream for credit unions, but there must be a balance between the <u>risks</u> and the <u>rewards</u>

Considering the Risks

Consumer Compliance Requirements:

- Regulation DD
- Regulation E
- Unfair, Deceptive, or Abusive Acts or Practices (UDAAP)

The bulk of overdraft requirements are found in two guidance documents issued by the regulatory Agencies:

1. 2005 Interagency Joint Guidance on Overdraft Protection Programs
2. 2010 Overdraft Payment Supervisory Guidance
    - Compliance with the 2010 Guidance is a best practice for non-FDIC supervised institutions

It is crucial for credit unions to minimize their risks associated with overdraft products

Considering the Risks

Consumer Compliance Requirements: Regulation DD (TISA):

- TISA Disclosures related to overdraft payment programs are divided into two separate sets of disclosures:

  1. Account Opening (TISA) Disclosures

  2. Periodic Statements

Considering the Risks

Consumer Compliance Requirements: Regulation DD (TISA):

1. Account Opening (TISA disclosures)

- Must include the amount of any fee that may be imposed in connection with the account and the conditions under when a fee may be imposed, including overdraft fees
- Institutions must specify the categories of transactions under which an overdraft fee may be imposed
  - Exhaustive list of categories of transactions is not required
  - It is sufficient for the disclosure to state that the fee applies to overdrafts “created by check, in-person withdrawal, ATM withdrawal, or other electronic means
    - Disclosing a fee “for overdraft items” is not sufficient

Considering the Risks

Consumer Compliance Requirements: Regulation DD (TISA):

2. Periodic Statement Disclosures:

An institution must disclose on each statement, as applicable:

- The total dollar amount for all fees or charges imposed on the account for paying checks or other items when the account becomes overdrawn using the term Total Overdraft Fees; and

- The total amount for all fees imposed on the account for returning items unpaid using the term returned item fee or NSF fee

Considering the Risks

Consumer Compliance Requirements: Regulation E

Before an institution may charge a fee for paying a one-time debit card or ATM transaction that overdraws a consumer's account, the institution must:

- Provide the consumer with a notice describing the overdraft program
- Provide a reasonable opportunity for the consumer to opt-in (consent) to the service for ATM and one-time debit card transactions
- Document the consumer's consent to opt-in for the institution's payment for ATM and one-time debit card transactions
- Provide the consumer with confirmation of the consent that includes a statement of the consumer's right to revoke consent (opt-out)

Notice and confirmation of consent must be provided in writing unless the consumer's agrees to receive it electronically (ESIGN)

Considering the Risks

Consumer Compliance Requirements: Regulation E

The opt-in notice must be substantially similar to Model Form A-9 in Appendix A of Reg. E.

It must include all of the following and no other information:

- A brief description of the Overdraft Program
- Fee amounts
- Limits on fees charged
- An explanation of the consumer's right to opt-in to the institution's payment of overdrafts for ATM and one-time debit card transactions
- If available, the institution must inform the consumer of alternative plans for covering overdrafts that may be less costly (e.g. sweep feature or line of credit)

Considering the Risks

Consumer Compliance Requirements: Disclosing the Account Balance

When an institution discloses a consumer's account balance through an automated system, the balance may not include the additional funds available through the Overdraft Program to cover items that overdraw the account

- Applies to any automated system such as telephone balance request, ATM, or online banking

The institution may disclose additional balances that includes funds available through the Overdraft Program as long as it clearly conveys that the balance includes "overdraft funds"

- Any second balances disclosed may not simply state "available balance" or "available funds," for example

Considering the Risks

Payment Processing

2005 Joint Guidance requires institutions to clearly explain to consumers that transactions may not be processed in the order in which they occur

- Does not require any specific order

2010 Supervisory Guidance stated that institutions are expected to review their check-clearing order to ensure they do not maximize consumer overdrafts and related fees

Best Practices:

- Process transactions in a neutral order (e.g. by check number or order received)
  - Highest item first is not considered neutral as it tends to increase the amount of overdraft fees

Considering the Risks

Marketing Risks:

The 2005 Joint Guidance indicates that institutions should not market (advertise) the program in a manner that encourages overdrafts

- Instead, it should be presented as a discretionary service that may cover inadvertent overdrafts
- Inform consumers of other overdraft services, if any, that are available and how the terms of those products differ
- Institutions should not represent that payments of overdrafts are guaranteed or assured
- Disclose the true costs of the program
- Do not advertise accounts as “free” and overdraft programs in the same advertisement
- Institutions should disclose that more than 1 overdraft fee may apply per day

Considering the Risks

Excessive or Chronic Use:

The 2010 Supervisory Guidance states that institutions should monitor programs for excessive or chronic use, and if a consumer overdraws his or her account in more than 6 occasions where a fee is charged in a rolling 12-month period, then perform *meaningful and effective follow-up* with the consumer

- Best Practice

What does it mean to perform a meaningful and effective follow-up?

- Reasonable efforts should be made to provide the consumer information on alternative overdraft payment programs that may be less costly and better suited for the individual
- Maintain a regular program to inform such users of overdraft usage and cumulative costs in a clear and conspicuous manner
- Provide a method to contact the institution to discuss alternatives

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Considering the Risks

Demonstrating Meaningful and Effective Follow-up Cont…

Two examples of ways an institution could demonstrate meaningful and effective follow-up regarding excessive and chronic users are to provide:

1. *Enhanced periodic statements*
2. Targeted Outreach Approach

Considering the Risks

Demonstrating Meaningful and Effective Follow-up Cont…

1. Enhanced Periodic Statements:

In providing a periodic statement in accordance with Regulation DD requirements, an institution could include a message on the periodic statements that describes how the consumer could contact the institution to discuss alternatives

- Include the name or names of specific employees who have knowledge of alternative products

For example, the following statement could be used:

"You have been paying multiple overdraft fees and there may be cheaper alternative products that may be better suited for your needs. Please call [name of employee] at xxx-xxx-xxxx to discuss other options with a customer service representative or visit us at your local branch."

Considering the Risks

Demonstrating Meaningful and Effective Follow-up Cont…

2. Targeted Outreach:

In using this approach, an institution should initiate outreach within a reasonable time (e.g. 30 days) after a consumer incurs more than 6 overdrafts in a rolling 12-month period

- Discuss Overdraft usage and available alternatives that may be less costly
- If the consumer decides to remain in the overdraft program, the institution should inquire about the consumer's preference for future contact

Considering the Risks

Fee Limits and Maximizing Fees:

- Daily limits can help prevent a consumer's lapse in financial management from triggering a domino effect of overdraft fees
- Establishing a limit on fees will be viewed as a method for addressing chronic or excessive use of an automated overdraft payment program

For example, you may limit the number of transactions that will be subject to a fee (e.g. no more than 3 per day) or total allowable fees (e.g. max dollar amount in fees allowed per day)

Considering the Risks

Fee Limits and Maximizing Fees:

Establishing an appropriate *de minimis* overdraft amount –

- Institutions should consider the use of a *de minimis* threshold before an overdraft fee is charged in order to reduce reputational risk related to charging fees disproportionate to the item being cleared

- For example, you may implement a *de minimis* limit in which you do not charge an overdraft fee for underlying transaction amounts of less than $10; or decline to charge a fee for transactions of any mount that overdraw the account by less than an amount of $10

Considering the Risks

Fee Limits and Maximizing Fees:

The requirement to monitor usage and engage in effective follow-up to inform excessive users of available alternatives does not require an institution to terminate or suspend a member's access to the overdraft program if the consumer continues to engage in chronic or excessive use…

However –

Institutions should take appropriate action to mitigate risks associated with excessive and chronic users

- Reputational
- Compliance
- Safety and Soundness

Mitigating the Risks

Best Practices to Reduce Risks:

The 2005 Joint Guidance and the 2010 Supervisory Guidance suggest a number of best practices to consider, including:

Opt-outs:

- Providing consumers an election to opt-out of the service
- Don’t make the procedure to opt-out difficult or impractical
- Provide clear instruction

Mitigating the Risks

Best Practices to Reduce Risks:

Alerts:

- Employing cost-effective, existing technology to alert consumers when their account balance is at risk of becoming overdrawn or incurring a fee
- Automated text message, email, or phone call
- Allow the consumer to establish a balance by which an alert will be sent once it reaches the specified amount

Mitigating the Risks

Best Practices to Reduce Risks:

Notices:

- Promptly notify consumers of overdraft program usage each time used as of the day a fee is charged
- The notice should include:
  - Date of the transaction
  - Type of transaction (e.g. ATM or one-time debit card purchase)
  - Overdrawn amount
  - Amount of the fee associated with the overdraft
  - The amount needed to bring the account positive
  - Time-frame in order to bring the account positive to avoid an additional fee

Mitigating the Risks

Best Practices to Reduce Risks:

Daily Limits:

- Preventing a consumer's individual lapse in financial management from triggering a cascade of overdraft fees
- Mitigate UDAAP Risks by establishing a daily limit on overdraft fees (e.g. 3 per day) or limit a dollar amount of allowable fees per day

De minimis overdraft:

- Eliminating overdraft fees for transactions that overdraw an account by a de minimis amount
- If a fee is charged, the fee should be reasonable and proportional to the amount of the transaction to reduce reputational risks as well as UDAAP

Mitigating the Risks

Best Practices to Reduce Risks:

Education:

- Providing information to consumers about how to access free or low-cost financial education workshops or counseling to learn how to better manage personal finances
- Demonstrates to examiners your willingness to prioritize the consumers' best interest over potential revenue

Mitigating the Risks

Other considerations to reduce overall compliance and safety and soundness risks:

- Ensure the board of directors provides oversight of the program, including an annual review
- Review internal and external audits of all marketing pieces, disclosures, and program implementation to promote program responsibility and mitigate any consumer confusion
- Train all staff on how to appropriately explain the program's features and any other choices available

Thank You

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