

# OFFICE OF FINANCIAL INSTITUTIONS

## OFI BULLETIN

**BL-03-2003**  
**February 12, 2003**

**TO: THE CHIEF EXECUTIVE OFFICER/MANAGER**

**SUBJECT: RISKS OF OVERDRAFT PROTECTION PROGRAMS**

*[NOTE: Please see that this e-mail message gets to the Chief Executive Officer of this financial institution.]*

There is a new spin to an old service that many depository institutions are considering offering to their customers--overdraft protection plans or what is sometimes referred to as "bounce protection." The OCC has written a very detailed advisory opinion which summarizes their concerns regarding a myriad of federal regulations that may be violated, as well as supervisory and policy issues regarding these plans. Attached is a copy of the OCC's Interpretive Letter #914 for further guidance. Some of the issues raised by the OCC, along with the most controversial one regarding Truth in Lending/Regulation Z, include the following:

- Truth in Savings/Regulation DD -- proper notification of a significant change in a deposit account as defined in the regulation
- Electronic Fund Transfer Act/Regulation E -- proper documentation is required when preauthorized transfers from a checking account at another financial institution are used to repay an overdraft
- Equal Credit Opportunity Act/Regulation B -- consistent standards for determining whether a customer is eligible or ineligible for a program
- Federal Trade Commission Act -- regulations to prevent deceptive acts or practices that will mislead a reasonable consumer
- Regulation O -- prohibitions of preferential treatment of bank insiders

You should note the first area of concern listed on the OCC's summary (Regulation Z) because any violation of this section would also be a violation of LSA-R.S. 9:3511(E), Louisiana Consumer Credit Law (LCCL).

One of the following factors must be present for an overdraft charge to be considered a finance charge: (1) The charge must be previously agreed upon in writing--generally in the form of a loan document. A written deposit agreement in which the depositor agrees to a charge when the account becomes overdrawn does not appear to satisfy this requirement. (2) The financial institution must agree in writing to automatically pay items that would cause the deposit account to be overdrawn. Again, in our review of Regulation Z, if neither of these factors is present, the charges are not subject to the limits and restrictions of Regulation Z or the LCCL.

[NOTE: Presently, the Federal Reserve is reviewing comments they requested from bankers on how overdraft protection services are designed and operated and how these services should be treated for purposes of the Truth-in-Lending Act. Depending on the Federal Reserve's final guidance issued on this topic, the above interpretation of Regulation Z may change.]

While it is possible for a financial institution to administer this program in a manner that is in full compliance with all of the federal (and state) regulations listed on the OCC's summary sheet, there is a significant amount of reputational risk associated with a program that is not administered in a manner that customers perceive as being fair. Here are a few examples of the nature of complaints regarding overdraft protection plans that this office has received.

- A customer received no prior notice that he was enrolled in this new overdraft protection plan until he noticed an overdraft fee of \$25 plus an additional \$5 charge for every day that his account remained overdrawn. When asked to have the service removed from his account, the bank required that the customer put the request in writing.
- A customer withdraws cash from his account using an ATM. Before the cash was dispensed, a screen was posted on the ATM that stated something like "Account balance = \$100. Available balance = \$150. Are you sure you want to continue with the transaction?" Not realizing the difference between account balance and available balance, the customer chose to withdraw \$150. Three weeks later, the customer received his statement and noticed an overdraft charge of \$25 plus a daily charge of \$5 for 15 days that the account remained overdrawn for a total of \$100 in service charges.

- This service is often attached to accounts that financial institutions call “totally free checking accounts.” In some cases, customers would not qualify for an unsecured line of credit but are given “overdraft protection.” Even though very small overdraft limits may be put on these customers, the practice may be considered “predatory lending” if the customers being targeted for this service are not otherwise entitled to such a “privilege.”

Even though the examples listed above may not describe violations of any federal or state law, one disgruntled customer could publicize his/her negative opinion of the practice in a disparaging light; and it may be difficult to justify the program in a “court of public opinion.” You may avoid any significant reputational risks by initiating some of the following practices with regard to overdraft protection plans.

- Describe the benefits of the plan and allow the customer the opportunity to refuse the service before automatically being enrolled in the program.
- Reserve this service for customers who would otherwise qualify for a small unsecured loan or those for which the bank would normally pay their reasonable overdrafts.
- When an account goes into an overdraft status, notify the customer that the overdraft protection service has been invoked.
- Perform some type of evaluation on each customer enrolling in the plan and set a reasonable limit on the amount and frequency of the overdrafts to be allowed. Properly notify the customer of his/her limits.
- Give proper notification to the customer if he/she has reached his/her limit or for another reason will no longer be allowed to participate in the plan. Even though documents describing these plans clearly state that the bank may withhold this privilege and not pay an overdraft at any time, the customer may expect the privilege.
- Add explanations to ATM screens that clearly state the difference between an actual and available balance and the additional costs associated with the withdrawal of the available balance.
- Maintain a file of all complaints received on the program and be responsive to valid complaints.
- Consistently apply the program rules to all qualified customers who are offered the service.

Before a financial institution offers an overdraft protection program, the Board should be fully aware of the reputation, credit, and liquidity risks involved. Consider the following:

- Carefully establish the rules for the program to ensure that they are fair and do not target specific demographics.
- The loan policy should address underwriting guidelines, including evaluation of repayment capacity to determine limits, appropriate collection and charge-off procedures, allowance for loan and lease loss guidelines, and guidelines for informative Board and management reports for monitoring purposes.
- Consider the impact of an overdraft protection program in other areas, such as unfunded loan commitments, when evaluating liquidity and funds management.
- Ensure compliance with all state and federal laws. A summary of those laws appears on page 1 of this bulletin and are discussed in the OCC Interpretive Letter that is attached.
- Consider reputation risk associated with customers who may be dissatisfied with the way in which the program is administered.

The examination focus will be to assess the risks an institution has accepted by offering an overdraft protection program to its customers, as well as compliance with applicable statutes. In order to do so, examiners will review any documents describing the program, the manner in which the program is administered, any complaints received, disposition of such complaints, and the extent to which the institution has prepared for the risk by incorporating applicable provisions into the institution's credit and liquidity/funds management policies. Deficiencies will be summarized in the Report of Examination and reflected in the appropriate CAMELS component(s).

If you have any questions, please call your assigned Review Examiner or Deputy Chief Examiner Kerry Morris at (225) 925-4660.

**Attachments** – OCC's Interpretive Letter #914 dated August 3, 2001

FRB's proposal to revise the official staff commentary to Regulation Z (see p. 7 of the proposal)