



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

August 3, 2001

Interpretive Letter #914
September 2001
15 USC 1691
12 CFR 215
12 CFR 226
SBJ CONS

Subject: [*3rd Party*]
[*Program*]

Dear []:

This letter responds to your correspondence with Brenda Curry, District Counsel of our Southeastern District Office, which was referred to our Washington Headquarters office. You had formally requested a program evaluation/comfort letter in connection with [*an overdraft protection program*] (Program) offered by [*3rd Party*].

We have reviewed the materials that were submitted along with your letter, and we are unable to provide such a letter. In our view, the Program presents a number of concerns, which we summarize below.

Compliance Issues

Truth in Lending/Regulation Z

An overdraft would be “credit,” as defined by the Truth in Lending Act and Regulation Z. 15 U.S.C. § 1602(e). The key issue under Regulation Z, however, is whether the fee charged in connection with the overdraft is a “finance charge.” The answer would depend on:

- Whether a nonsufficient funds (NSF) fee charged by the bank is the same whether the NSF check is paid or returned; and
- Whether there is an agreement between the bank and the accountholder pursuant to which the bank will pay the accountholder’s NSF checks and impose a fee for doing so.

See 12 C.F.R. §§ 226.4(b)(2) and (c)(3).

If the fee were determined to be a finance charge, the bank would have to make the disclosures required in Regulation Z for open-end credit. *See, e.g.*, 12 C.F.R. §§ 226.5 and 226.6.

Truth in Savings/Regulation DD

Certain fees must be disclosed in connection with a deposit account. At the time an account is opened, the disclosures must include the amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed. 12 C.F.R. § 230.4(b)(4).

If the Program were added to an already existing deposit account, advance notice to the accountholder may be required. A bank must give advance notice (at least 30 days before the change) to affected customers of any change in a term that was required to be disclosed under § 230.4(b) (which includes fees imposed in connection with the account) if the change may reduce the annual percentage yield or adversely affect the consumer. 12 C.F.R. § 230.5(a)(1).

Electronic Fund Transfer Act/Regulation E

In connection with the [] Repayment Agreement, the customer is urged to repay the amount of the unpaid overdraft over time through preauthorized transfers from his/her checking account. A participating bank would need to comply with the Regulation E requirements for preauthorized transfers. 12 C.F.R. § 205.10(b).

Equal Credit Opportunity Act/Regulation B

An “overdraft” would be “credit” under Regulation B. *See* 12 C.F.R. § 202.2(e). A memorandum from [A] of [3rd Party] to [B], dated June 10, 2000, provided criteria for selecting “ineligible (excluded) accounts,” i.e., those accounts that are not eligible for the Program. Among those accounts are: “Accounts which, *in reviewing officer’s judgment*, should *not receive* the automated overdraft payment service, such as (See sample memo): Not creditworthy or questionable financial condition.” (Emphasis in original.)¹

The materials do not appear to provide any indication of standards for the reviewing officer’s determination. When a decision is left to bank personnel’s discretion, there may be a potential for disparate treatment in violation of ECOA and Regulation B. *See* 12 C.F.R. § 202.4.

Federal Trade Commission Act

The Federal Trade Commission Act prohibits deceptive acts or practices, including representations or omissions that are likely to mislead reasonable consumers and, thus, affect a consumer’s choice or conduct regarding a product. *See* 15 U.S.C. § 45(a)(1) and the FTC Policy Statement on Deception (October 14, 1983).

¹ Elsewhere the materials provide that the management component of the program “involves the Operations person making judgments on when to pay over the specified limit, when to restrict or otherwise curtail the privilege, when to charge off delinquent accounts.”

The marketing materials for the Program send a mixed message as to whether the bank is committing to pay overdrafts as long as the account meets the stated qualifications for the Program and also raise numerous ambiguities about or overstate the benefits of the Program:

- In a number of places the materials make such statements as “we *will* pay your checks ... if you maintain your account in good standing.” The back of the marketing materials, however, states that “we may refuse to pay an overdraft for you” and that this is being done as a “non-contractual courtesy.”²
- The materials give the wrong impression about the scope of the protection offered by the program and oversell its benefits. Claims of “no more charges from retailers for insufficient checks,” “make a mistake -- you’re covered,” and “write a check or use an ATM for more than you have in the bank -- you’re covered” are broad statements given the limitations placed on the program.
- The materials may leave the customer with the wrong impression about what the actual overdraft limits are. For instance, with respect to an account to which a \$500 limit is applicable, the bank would not, under the program, pay an overdraft that exceeded \$480 because the \$20 NSF fee, would cause the overdraft to exceed the \$500 limit.³
- The requirement that the account need only be brought to a positive balance once every 30 days also may be illusory. We note that the materials provide that “The

² Other materials also introduce language that could be construed as providing a basis for the bank to not pay overdrafts despite representations otherwise. Marketing materials state that if an account is in good standing, the bank will “*normally*” pay overdrafts up to the stated limits. At another point in the materials, it states that if the account is in good standing we will approve your “*reasonable*” overdrafts. Elsewhere, the materials refer to the program as a “non-contractual customer courtesy that can be withdrawn at any time.” In addition, the requirement of a positive balance at least once every 30 days is, at some places, stated as the “need to make regular deposits to bring the account to a positive balance at least once every 30 days.” It is unclear if this is one test or two – in other words, even if the account is brought to a positive balance in 30 days, can the overdraft feature be terminated if the bank did not consider “regular deposits” to have been made and, if so, what constitutes the making of “regular deposits.”

³ The marketing materials address this but only in a rather oblique way:

[Program] adds a pre-approved \$500 overdraft limit to your personal checking account. If you overdraw your account, Bank will cover each check up to \$500 limit. You still pay Bank’s standard overdraft fee for each item returned, but the benefits are worth it.

This representation nowhere alerts the customer that Bank will not, under the program, pay a check in an amount between \$480 and \$500 or pay, for instance, five overdraft checks in an amount between \$400 and \$500. Where the disclosure about the relationship between fees and the overdraft limit is made, it is set forth in an unduly complicated manner: “... we will normally honor (pay) your overdrafts up to the limits mentioned above, including our normal Non-Sufficient Funds (NSF) Charge(s).” It is not readily apparent that this disclosure would alert a customer that the overdraft fees are deducted from the overdraft limit.

amount of any overdrafts plus our Non-Sufficient Funds and/or Overdraft (NSF/OD) Charge(s) that you owe us shall be due and payable upon demand.”⁴

Regulation O

Overdrafts are considered extensions of credit for purposes of Regulation O. 12 C.F.R. § 215.3(a)(2). If, as some of the materials appear to indicate, a bank also makes this product available to certain bank insiders, issues would appear to arise under Regulation O governing extensions of credit to bank insiders.

Supervisory Concerns

Your characterization of the product as something other than lending raises supervisory issues:

- It is possible that overdrafts would be paid for customers who would not qualify for loans under the prudent underwriting standards that the bank should use for all of its extensions of credit. This could increase a bank’s credit risk profile (e.g., higher delinquency and loss rates) by extending credit to borrowers that may not have normally qualified for payment of overdrafts or overdraft protection;
- Given the loss history of bank overdraft programs, bank management must develop reasonable loss recognition guidelines and establish loan loss reserve methodologies to ensure timely loss recognition and estimated loss coverage.
- Although the submitted material indicates a measuring and monitoring process (infers MIS reporting), it is unclear what this entails, including the types and quality of information provided to a bank to assess credit risk performance on a periodic basis. Banks must have appropriate MIS reporting established.

⁴ This lack of forthrightness in dealing with customers also is demonstrated by a sample letter, advising a consumer that s/he has just a few days to bring his/her checking account to a positive balance, which indicates that the customer *may* qualify for the / / Repayment Plan; but a follow-up letter sent when the customer fails to bring the account to a positive balance within the time period advises the customer that s/he has been “pre-approved” for the / / Repayment Plan. Moreover, the materials generally indicate that a person who fails to bring the account to a positive balance in the allotted period will be offered the opportunity to repay the overdraft in equal installments spread over a period of from six to 12 months.

Moreover, the integrity of the various representations are also called into question by the following typed notation on one aspect of the disclosures:

[NOTE REGARDING POSITION OF FREE CHECKING: Position the disclosure somewhere in the middle of the checking account disclosures to avoid calling unnecessary attention to the Free Checking account.]

Banks also need to take great care in entering into contracts with third party vendors.⁵ This raises a variety of supervisory concerns that banks should address before entering into an arrangement with a vendor in connection with the potential purchase of products including:

- Most banks have software already capable of overdraft protection without incurring the high up-front and ongoing costs of the Program. Consequently, the benefits of the Program are not readily evident, in that a bank could otherwise achieve the same results if it implemented and marketed its existing capabilities;
- It appears that the arrangement a bank enters with the vendor to participate in the Program is devised in such a manner that only the bank is subject to the credit and reputation risk, while the vendor shares the benefits, i.e., the income;
- Banks are expected to conduct due diligence reviews of vendors. This includes initial and ongoing reviews of the financial information of any vendor. These reviews are necessary to ensure that the company can fulfill the representations as outlined in the contract. Requirements for the timing and quality of financial information should be set forth in the contract;
- The sample contract indicates a termination clause that appears to prohibit or severely restrict the contracting bank's ability to terminate once the program is initiated. Only the vendor has control of termination, and the only termination consideration is if the 150% fee income profitability goal is not achieved. This one-sided termination clause is potentially detrimental for the bank from a reputation, financial, and strategic risk perspective. Under the contract, the bank has no recourse if it becomes dissatisfied for a variety of reasons such as customer satisfaction/bank reputation and credit risk issues (e.g., 50% of the customers complain or 15% delinquency rate).

Policy Issues

The Program is designed to increase fee income by encouraging customers to write NSF checks. Although the Program may be valuable to customers who might inadvertently or infrequently write an NSF check, banks participating in the Program will, in essence, attempt to entice their customers to write NSF checks more frequently and on purpose in order to generate fee income. *This use of the Program could promote poor fiscal responsibility on the part of some consumers.*⁶

⁵ See OCC Advisory Letter No. 2000-9, "Third-Party Risk" (August 29, 2000).

⁶ The materials are contradictory with respect to a bank's expectations about the use that its customers will make of the program. On the one hand, a sample letter states that the program "is not an invitation to overdraw your account, it is an added layer of protection should you accidentally write checks for more than you have in the bank." On the other hand, marketing materials state: "Once you [the bank] and [3rd party] install and implement the process, a phenomenon occurs. Your customers will use it and use it and use it ... and your NSF income will soar." At another point, the marketing materials advise the customer: "This [overdraft privilege] is extended to you to provide additional flexibility and convenience in managing your funds" It belies logic to conclude that the customers

In this regard, we note the complete lack of consumer safeguards built into the program:

- in some circumstances the charges assessed on customers may be just as burdensome as those imposed on borrowers utilizing other types of high interest rate credit;⁷
- an unlimited number of overdraft charges could be levied during a 30-day period as long as the consumer does not exceed the dollar amount limitation on overdrafts;
- no cooling off period following the repayment of overdraft amounts during which no overdrafts would be paid, thus increasing the likelihood that a customer would consciously resort to use of this product to pay for ordinary day-to-day expenses;
- no grace period (for instance, 24 hours) during which the customer can reimburse the bank without incurring the NSF charge after receiving notice that a check was paid;
- no effort by banks offering this program to identify customers who are writing overdraft checks regularly as a means of meeting regular obligations in order to attempt to serve their needs through more economical alternatives; and
- no effort by banks offering the program to inform customers generally of available alternatives for short-term consumer borrowing, explain to customers the costs and advantages of various alternatives to the program, or identify for customers the risks and problems in relying on this product and the consequences of abuse.

Thank you for the opportunity to evaluate the Program. We hope that this information is useful to you.

Sincerely,

-signed-

Daniel P. Stipano
Deputy Chief Counsel

will *accidentally* “use it and use it and use it” and that the program is designed to provide accidental “additional flexibility and convenience” to customers in managing their funds.

⁷ For instance, a customer with a \$500 overdraft limit who writes seven NSF checks in a month for a total overdraft of \$360 would be assessed \$140. We note, too, the observation in the materials with respect to the *[repayment]* program that “the customer will be encouraged to come in, acknowledge the OD amount (a large portion of which will now be fees), and set up a payment plan.”