

DOES YOUR OVERDRAFT PROGRAM CHECK ALL THE BOXES?

WHAT YOU NEED TO KNOW ABOUT
MARKET CHANGES, RISKS, AND STRATEGIES

J|M|F|A

Four Letters. Infinite Potential.

Introduction

Overdrafts have existed since the beginning of banking. A merchant presents an item, and the account holder doesn't have the funds to cover the transaction. The account holder is assessed a non-sufficient funds (NSF) fee and the transaction is sent back to the merchant. Merchants realized long ago that they could re-present the returned items, hoping to collect the funds.

No matter whether it's a check or ACH transaction, financial institutions cannot control whether or when an item is re-presented. They also can't control when transactions are authorized on accounts with a positive balance, but then settled when the account no longer has the funds.

Over the years, overdrafts have gone from a courtesy — something that consumers rarely encountered — to a much more complex topic. With the volume of payment methods and electronic transactions, overdraft protection programs can be a valuable service to consumers.

At the same time, the associated fees have become a hot-button topic in recent years, with some practices being identified as predatory. Financial institutions may wonder if they're staying ahead of the curve in the current environment or if they're opening themselves up to regulatory and legal risk.

The good news is that even amidst a challenging environment, your financial institution can position itself to mitigate these risks with an overdraft program strategy that checks all the right boxes.

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The Spotlight on Overdraft Fees

In 2018, a [class-action lawsuit](#) was filed against Bank of America regarding the bank's practices, including the assessment of multiple fees on the same transaction. A merchant would re-present an item and the bank would assess a fee on each presentment if the account holder's account had insufficient funds. The basis of the claim was that the repeated attempts to process the transaction happened without the account holder's knowledge.

Bank of America settled the case for \$75 million in 2021. From that settlement, re-presentment fees captured the attention of other national banks, regulators, and litigators.

The Consumer Financial Protection Bureau (CFPB) completed an analysis of overdraft fees and financial institutions' reliance on that income. The [findings](#), published in December of 2021, revealed that overdrafts had an increase of only 1.7% annually and reliance on that fee income remains steady. Yet, shortly after that, CFPB Director Rohit Chopra released a [statement](#) in conjunction with the findings about "junk fees" — fees that act as penalties to the consumer in excess of what the service is worth.

That same month, Acting Comptroller of the Currency Michael Hsu [identified several features](#) of bank overdraft programs that could "support financial health" including grace periods, balance-related alerts, and allowing negative balances without triggering a fee. National Credit Union Association (NCUA) Chairman Todd M. Harper also held a webinar discussing ways credit unions should minimize member harm and maximize service delivery.

Sources:

- *Morris v. Bank of Am.*, 3:18-CV-157-RJC-DSC (W.D.N.C. Jan. 21, 2022)
- CFPB *Overdraft/NSF Fee Reliance Since 2015 – Evidence from Bank Call Reports*
- Michael Hsu "Reforming Overdraft Programs to Empower and Promote Financial Health"

THE COST OF CLASS ACTION

BANK OF AMERICA ORDERED TO PAY

\$75
Million

FOR FAULTY RE-PRESENTMENT
PRACTICES

CURRENT LEGISLATIVE EFFORTS

While there has been a lot of press regarding overdraft practices, it's important to note that nothing has changed legislatively at the federal level. The two major pieces of legislation being discussed — the Overdraft Protection Act and the Stop Overdraft Profiteering Act — have stalled in the House and Senate, respectively.

It is unclear if either of these bills will move forward. However, while legislators drive change, the industry has already adopted the cruxes of these two bills. Initial guidance from the FDIC dates back to 2005 and the bills only seek to codify existing overdraft practices into law.

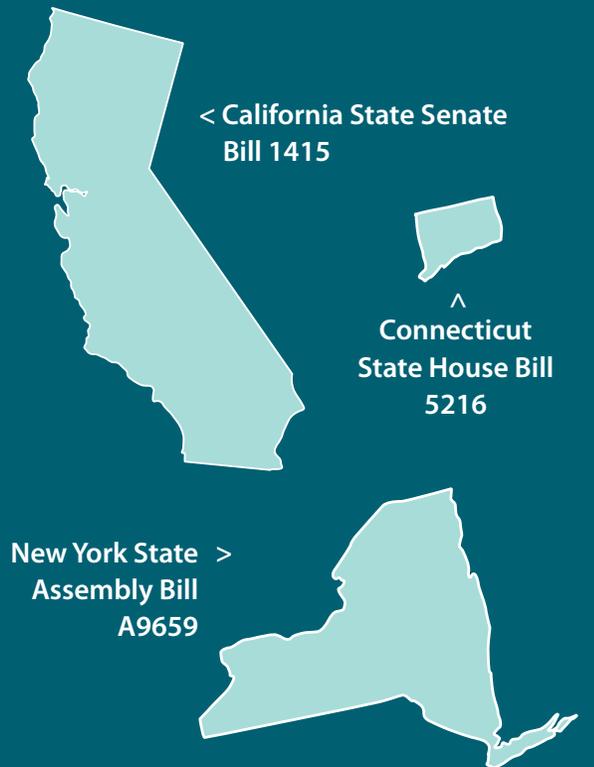
For financial institutions, it's essential to stay abreast with both federal and state legislative actions to avoid costly violations.

LEGISLATION	INTRODUCED BY	STATUS
Overdraft Protection Act	Carolyn Maloney (D-NY)	X Stalled in House
Stop Overdraft Profiteering Act	Cory Booker (D-NJ), Elizabeth Warren (D-Mass)	X Stalled in Senate

Sources:

- House Bill H.R.4277
- Senate Bill S.2677

Additionally, some states have recently introduced, passed or updated bills related to overdraft fees, communication, and revenue reporting requirements.



REGULATORY GUIDANCE

In March 2022, the FDIC [Consumer Compliance Supervisory Highlights](#) publication identified re-presentment fees as a potential violation of the Federal Trade Commission (FTC) Act for unfair or deceptive acts. Citing public statements by regulators and class-action lawsuits, the publication emphasized the financial harm to consumers when financial institutions charge multiple re-presentment fees. Failure to properly disclose re-presentment fees to consumers “may be deceptive.”

The findings also concluded that disclosures often outlined NSF fees “per item” or “per transaction” without clearly defining the terms or explaining that the same transaction could result in multiple re-presentment fees.

This was affirmed in August 2022 with FDIC [Supervisory Guidance on Multiple Re-Presentment NSF Fees](#). The guidance outlines that the supervisory response, “will focus on identifying re-presentment issues and ensuring the correction of deficiencies and remediation to harmed individuals.”

The Office of the Comptroller of the Currency (OCC) and the NCUA have not officially released any statements regarding their expectations; however, these agencies have historically followed the FDIC’s lead. It’s fair to say all financial institutions should be prepared to address re-presentments during their next exam.

Sources:

- *FDIC Consumer Compliance Supervisory Highlight, March 2022*
- *FDIC Supervisory Guidance on Multiple Re-Presentment NSF Fees, August 2022*

What is a Re-presentment Fee?

A re-presentment occurs when a merchant has presented a transaction, such as a check or ACH, and the transaction is declined due to insufficient funds in the account. The financial institution charges a non-sufficient funds (NSF) fee.

Subsequently, the merchant can re-present the transaction in an effort to obtain the funds. Additionally, the National Automated Clearing House Association (NACHA) rules for ACH debits allow items to be re-presented. This type of transaction can trigger the assessment of additional NSF fees by the financial institution. These subsequent fees are known as **re-presentment fees**.



THE CFPB

In October 2022, the CFPB issued guidance around surprise overdraft fees: fees that a consumer “cannot reasonably anticipate when the transaction incurs a fee.” The guidance, [Consumer Financial Protection Circular 2022-06](#), found that the assessment of an overdraft fee could constitute an unfair act or practice under the Consumer Financial Protection Act.

In its guidance, the CFPB noted that financial institutions have created “serious obstacles to consumers making informed decisions around their use of overdraft services.” While some national financial institutions have eliminated overdraft fees in response to the current environment, community banks and credit unions can look to the bureau’s recent guidance and other regulatory guidance around overdraft programs — and make transparent disclosures a key pillar of their overdraft protection programs. By doing this, consumers can make informed decisions.

Source:
- CFPB Circular 2022-06

What Is AP/SN?

Authorize positive settle negative (AP/SN) is a scenario in which a debit is authorized on an account while the account has funds, but when the transaction settles, the money is no longer available.



The CFPB determined that assessing fees in an AP/SN scenario is a “surprise fee” since the consumer believed that the funds were available at the time of the transaction. The regulatory body has been cracking down on financial institutions engaged in manipulative processes and counterintuitive practices related to AP/SN transactions.

Financial institutions should ensure that their core providers are not assessing fees for these types of transactions so they do not run afoul of the latest CFPB guidance.

THE COST OF UNFAIR AP/SN FEES

WELLS FARGO
ORDERED TO REFUND
\$205
Million

REGIONS BANK OF BIRMINGHAM, AL
ORDERED TO REFUND
\$191
Million

Sources:
- CFPB Wells Fargo NA 2022 Consent Order 2022-12
- CFPB Regions Bank Consent Order 2022-09



Understanding and Overcoming Potential Risks

As overdraft criticism has increased in recent years, financial institutions have been questioning their overdraft protection programs. Not only have the regulatory agencies been laser-focused in on overdraft fees, but media attention has also brought such programs to the forefront of consumer minds.

There are problems in the industry, no doubt. While there are financial institutions that offer a prudent, transparent, fully disclosed overdraft program, some have internal practices that could cause consumer harm.

The components of an overdraft program are complex, even for financial institutions that intend to provide overdraft solutions as a service. Organizations need to understand the potential risks so they can mitigate them.

“You can’t minimize the importance of disclosures in our environment. The best language in the right places is a part of your portfolio. You’re dealing with consumers, and they have a right to understand the service they’re using.”

*– Cheryl Lawson,
JMFA EVP of Compliance Review*



TECHNOLOGY RISKS

Going back to 2010, the banking industry received clear direction from regulatory agencies that the transaction posting order could harm account holders. High-to-low posting violates a consumer because the financial institution can potentially charge more fees than it should. As a result, all financial institutions had to address their posting order. This is an example of a technology risk: the core accounting system must support regulatory requirements.

Since the days of addressing high-to-low posting, other technology issues and challenges have arisen. The volume of electronic transactions continues to increase and the flurry of activity on an account means that a debit transaction can be authorized when an account has a positive balance but be settled when the account has a negative balance. This issue is directly referenced by the new CFPB guidance as a “surprise fee.” Financial institutions need to work with their core providers to ensure that fees are not assessed in error.

The same is true for multiple fees on re-presentment items. Not all core providers have reporting functionality to identify and report on these transactions. Financial institutions need to ensure that they have foolproof disclosures, policies, and procedures in place to address and correct the issue.

How items are posted, whether an item is assessed an NSF fee, and the balance of the account at the time of authorization versus the time of settlement represent additional technology issues that banks and credit unions need to work through.



COMMUNICATIONS RISKS

One of the most critical components of an effective overdraft solution is telling consumers everything they need to know about the service, which includes using easy-to-understand terminology and defining when fees will be assessed.

Some of the large banks didn't have any disclosures around re-presented items or even disclose overdraft limits to account holders. They lacked transparency around when items were paid and didn't provide education around re-presentation item fees. These industry behemoths were worried about creating clear disclosures: they viewed removing overdraft fees altogether as easier than providing transparency to consumers. Agencies have said that institutions may be at risk for an Unfair, Deceptive, or Abusive Acts or Practices (UDAAP) violation without proper disclosure.

Furthermore, financial institutions face risks in keeping their disclosures and notifications current. They can't solely rely on a technology partner to provide proper disclosures. Institutions need to ensure that regulations and guidance are regularly reviewed and disclosures are updated appropriately.

Internal communication and training must also be evaluated. It's not uncommon for branch personnel to have different understandings of the nuances when explaining a service. This was confirmed by an FDIC study several years ago where employees at different branch locations were asked about their bank's policies and programs. Employees gave inconsistent answers or, in some cases, didn't know the answer. A lack of consistent education can lead to confusion.

While disclosures and employee education certainly pose risks, they are both risks that can be mitigated through transparent disclosures and ongoing employee training. Both should be regularly addressed to ensure that they reflect current regulatory guidance.



LITIGATION RISKS

Every financial institution is at risk of a lawsuit. Litigators in recent years have targeted overdraft programs, looking for account holders willing to make a claim.

Unhappy consumers make easy plaintiffs, and law firms have been issuing demand letters to financial institutions of all sizes. A community bank or credit union could be doing everything right and still find itself subjected to a lawsuit.

The best solution to fight litigation is to maintain a strong defense. Institutions that document their programs and prove they are doing everything right have a much lower chance of litigation. Policies and procedures that are sensitive to consumers can reduce the risk of “unhappy” account holders that agree to be a plaintiff.

Trends in Exam Preparation

Examiners have increased their scrutiny around re-presentation fees ranging from their policies to reporting.

Financial institutions must be prepared to share their existing policies and disclosures. Additionally, reports with historical data have never before been requested. Unfortunately, only some core processors are equipped to provide them.

At JMFA, we help clients address all elements of the FTC Act to ensure they're responsive. Proper disclosures and consumer-friendly policies illustrate compliance with current regulations and guidance without relying on re-presentation reports.



Overdraft Program Best Practices

With the increased regulatory scrutiny and potential for lawsuits, some of the largest banks in the country, such as Wells Fargo and Capital One, decided to “eliminate” overdraft fees rather than change their policies or address concerns from the regulators. The reactions from these industry giants have created uncertainty in community financial institutions, wondering if they need to make similar changes.

However, there’s no reason that community financial institutions need to follow suit. The big banks decided to eliminate overdraft fees rather than make the program, technology, or disclosure changes that would satisfy the regulators and stave off potential lawsuits.

When a consumer is properly educated and disclosures address the issues raised by the regulatory agencies, there’s no reason to discontinue offering a valuable service. Financial institutions can follow some best practices to mitigate their risks.



CONSUMER-FRIENDLY BEST PRACTICES

GRACE PERIOD

If a transaction is presented that would trigger an overdraft or NSF fee, give the account holder a grace period to make a deposit before assessing a fee.

DE MINIMIS

A consumer-friendly de minimis is a way to provide a more consumer-centric overdraft service. Instead of charging a fee for every transaction that takes an account negative, consider only charging the fee if the account becomes negative by a threshold amount. (For example, \$5 and \$10 thresholds are common.)

REASONABLE FEES

Assess the reasonableness of your overdraft and NSF fees relative to the local market to ensure the fees are not prohibitive to account holders.

DISCLOSURES

Provide disclosures that educate account holders on the issue of re-presentation and outline when NSF fees will be assessed.

NOTIFICATIONS

Give account holders the ability to cure the account. Provide easy-to-understand notices, educate account holders that the item could be re-presented, and inform them of the potential associated costs.

The decision to implement one or more of these best practices can be challenging. Financial institutions should look at data and how their account holders use overdraft services — and align that information with their overall goals for an overdraft program. Measuring and evaluating impact should be part of the decision-making process.



Consumer Relationships Matter

Invariably, consumers will have unintentional overdrafts and when that occurs, they need some support. Overdraft programs continue to be a valuable service to account holders.

People are looking for a financial partner that instills trust, and at the end of the day, local financial institutions are well-positioned to fill that relationship. Community banks and credit unions should emphasize that relationships set them apart from their large counterparts: they have their account holders' backs.

For all the recent scrutiny of overdraft protection programs, they're designed to make banking better for account holders that take advantage of the opportunities they provide. The American Bankers Association did a [survey](#) and found that most people want access to overdraft services, as long as they understand the associated fees.

Different populations have different needs for overdraft services, which is why it is important for financial institutions to examine their account holder base. Some view overdraft services as a lifeline, especially during economically challenging times. In other cases, overdrafts empower consumers to improve their financial health in covering a one-off overdraft, such as a mortgage payment, due to an unrelated unexpected expense.

When managed responsibly, overdraft protection is a consumer-friendly service. Over time and through sound partnerships, financial institutions can retain more accounts and increase lifetime value via other services such as loans or wealth management. When loyalty increases, consumer deposits increase as well.

Source:

- Morning Consult online survey on behalf of ABA, 2022

Why JMFA

As the market has shifted in recent years, community financial institutions have found it challenging to stay on top of regulatory expectations. Part of the solution is having a partner with the expertise and resources to make proactive adjustments as necessary.

JMFA clients have fully disclosed overdraft solutions empowering their account holders with details about how the service works, including the cost and their processes. This enables account holders to make educated decisions and avoid being surprised by fees they could not have anticipated.

We provide a written 100% compliance guarantee, which safeguards the risk of regulatory fines or penalties. We also offer support and guidance for navigating litigation issues and regulatory exam preparation.

With over 40 years of experience, JMFA provides comprehensive overdraft consulting with consumer-focused recommendations and data-driven results to address the ever-evolving needs of today's financial institutions.

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