



# RESCINDED

Office of Thrift Supervision

Department of the Treasury

Managing Director, Examinations, Supervision, and Consumer Protection

1700 G Street, N.W., Washington, DC 20552 • (202) 906-7984

This document and any attachments are superseded by OCC Bulletin 2005-9 - Overdraft Protection Programs.

February 18, 2005

**MEMORANDUM FOR: CHIEF EXECUTIVE OFFICERS**

**FROM:**

Scott M. Albinson

**SUBJECT:**

Guidance on Overdraft Protection Programs

On February 14, 2005, the Office of Thrift Supervision (OTS) issued the attached final guidance on overdraft protection programs for savings associations. The guidance will assist you in ensuring adequate account administration and disclosures to consumers in connection with overdraft protection programs.

The final OTS guidance provides significant flexibility to you in designing and implementing overdraft protection programs, but also requires you to implement programs in a manner that fairly and equitably respects the interests of your customers. The guidance includes examples to illustrate specific marketing, disclosure, and implementation features of some overdraft protection programs that are of concern to OTS. Savings associations providing overdraft protection programs must implement appropriate policies and procedures adequate to address associated risks. We expect you to administer prudent risk management practices and incorporate best practices into your program. Best practices described in the final OTS guidance address the marketing and communications that accompany the offering of overdraft protection services, as well as the disclosure and operation of program features.

Questions regarding this guidance should be directed to your OTS regional office.

Attachment

Dated: February 14, 2005.

**Martha Curry,**

*Acting Director, Taxpayer Advocacy Panel.*

[FR Doc. 05-3219 Filed 2-17-05; 8:45 am]

BILLING CODE 4830-01-P

## DEPARTMENT OF THE TREASURY

### Office of Thrift Supervision

[No. 2005-05]

#### Guidance on Overdraft Protection Programs

**AGENCY:** Office of Thrift Supervision, Treasury (OTS).

**ACTION:** Final guidance.

**SUMMARY:** OTS is issuing this final Guidance on Overdraft Protection Programs (Guidance). This Guidance is intended to assist savings associations in the responsible disclosure and administration of overdraft protection services.

**DATES:** This Guidance is effective February 18, 2005.

**FOR FURTHER INFORMATION CONTACT:** Maurice McClung, Program Manager, Market Conduct, Thrift Policy, (202) 906-6182; Richard Bennett, Counsel, Regulations and Legislation Division, (202) 906-7409, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

OTS has developed this final Guidance after careful consideration of comments received on the proposed Interagency Guidance on Overdraft Protection Programs, 69 FR 31858 (June 7, 2004) (proposed guidance) issued by the Federal Financial Institution Examination Council (FFIEC) agencies, i.e., the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), and National Credit Union Administration (NCUA). It addresses a service offered by insured depository institutions commonly referred to as "bounced-check protection" or "overdraft protection." This service is sometimes offered to transaction account customers as an alternative to traditional ways of covering overdrafts (e.g., overdraft lines of credit or linked accounts). While both the availability and customer acceptance of these overdraft protection services have increased, aspects of the marketing, disclosure, and implementation of some of these programs have raised concerns for OTS.

The proposed guidance identified the historical and traditional approaches to providing consumers with protection against account overdrafts and contrasted these approaches with the more recent overdraft protection programs that are marketed to consumers. The Agencies also identified some of the existing and potential concerns surrounding the offering and administration of such overdraft protection programs that have been identified by Federal and State bank regulatory agencies, consumer groups, financial institutions, and their trade representatives.

In response to these concerns, the Agencies provided proposed guidance in three primary sections: Safety and Soundness Considerations, Legal Risks, and Best Practices. In the section on Safety and Soundness Considerations, the Agencies wanted to ensure that financial institutions offering overdraft protection services adopt adequate policies and procedures to address the risks associated with these services. The Legal Risks section of the proposed guidance outlined several federal consumer compliance laws, generally alerted institutions offering overdraft protection services of the need to comply with all applicable Federal and State laws, and advised institutions to have their overdraft protection programs reviewed by legal counsel to ensure overall compliance prior to implementation. Finally, the proposed guidance set forth Best Practices that serve as positive examples of practices that are currently observed in, or recommended by, the industry. Broadly, these Best Practices address the marketing and communications that accompany the offering of overdraft protection services, as well as the disclosure and operation, of program features.

The Agencies received a total of over 320 comment letters in response to the proposed guidance. Comment letters were received from depository institutions, trade associations, vendors offering overdraft protection products, and other industry representatives, as well as government officials, consumer and community groups, and individual consumers.

##### II. Overview of Public Comments

The Agencies received comments that addressed broad aspects of the proposed guidance, as well as its specific provisions. Many industry commenters, for instance, were concerned about the overall scope of the proposed guidance and whether it would apply to financial institutions that do not offer bounce protection programs but do cover the

occasional overdraft on a case-by-case basis. Commenters also addressed the three specific sections of the proposed guidance.

In regard to the Safety and Soundness section, for example, many industry commenters suggested extending the charge-off period from 30 days to either 45 or 60 days because they believed a longer charge-off period would provide consumers with more time to repay overdrafts and avoid being reported to credit bureaus as delinquent on their accounts. Comments were also received addressing technical reporting and accounting issues.

The Agencies received numerous comments regarding the Legal Risks section, particularly the Truth in Lending Act (TILA) and Equal Credit Opportunity Act (ECOA) discussions. For instance, many consumers and consumer group comments stated that overdraft protection should be considered credit covered by TILA's disclosures and other required protections. They likened the product to payday lending, which is covered by TILA. Many industry commenters argued against the coverage of overdraft programs by TILA and the Board's Regulation Z, and urged that the payment of overdrafts does not involve credit and finance charges requiring the disclosures and protections afforded by this body of law.

Lastly, many commenters offered specific criticisms or recommended edits with respect to particular Best Practices identified in the proposal. Several industry commenters sought general clarification of whether examiners would treat the Best Practices as law or rules when examining institutions offering overdraft protection services.

##### III. Final Guidance

This final Guidance incorporates changes made by OTS to provide clarity and address many commenter concerns. Language has been added to clarify the scope of the Guidance. The Safety and Soundness section expressly states that it applies to all methods of covering overdrafts. The introduction to the Best Practices section clarifies that while OTS is concerned about promoted overdraft protection programs, the Best Practices may also be useful for other methods of covering overdrafts.

In response to the comments regarding the Safety and Soundness section, OTS now indicates that overdraft balances, including uncollected fees, should generally be written off when considered uncollectible, but no later than 60 days from the date first overdrawn. This OTS

Guidance does not address whether overdrafts are credit because OTS believes that some "bounce protection" programs are provided to customers as a fee for service rather than an extension of credit. Other overdraft plans, particularly those where the savings association performs a credit check on the borrower, provide a period of time to repay the overdraft, and charge interest based on the amount and time the overdraft is outstanding, are loans. It is not within the scope of this Guidance to make a determination of whether any particular overdraft program is credit. Other technical edits have been made to further clarify reporting and accounting aspects of this section of the Guidance.

This OTS Guidance has eliminated the discussion of Legal Risks. This section engendered substantial comment and controversy, particularly over whether overdrafts are credit for purposes of TILA and Regulation Z.

OTS reminds savings associations, however, that overdraft protection programs must comply with all applicable Federal laws and regulations. It is important that savings associations have their overdraft protection programs reviewed by counsel for compliance with all applicable laws prior to implementation. As these laws and regulations are subject to amendment, savings associations are reminded to monitor applicable laws and regulations for revisions and to ensure that their overdraft protection programs are fully compliant with them.

Lastly, OTS reaffirms that the Best Practices are practices that have been recommended or implemented by financial institutions and others, as well as practices that may otherwise be required by applicable law. The Best Practices, or principles within them, are enforceable to the extent they are required by other federal statutes and regulations. The final Guidance explicitly states that while OTS is particularly concerned about promoted overdraft protection programs, the Best Practices may also be useful for other methods of covering overdrafts. OTS also revised or shortened numerous Best Practices for clarity, in response to particular commenter suggestions.

OTS's Best Practices depart from those in the proposed guidance issued by the FFIEC agencies in a few respects. OTS's Best Practices include not manipulating transaction-clearing (including, but not limited to, check-clearing rules and batch debit processing) to inflate fees and not allowing consumers to access overdraft amounts unless the consumer is informed that the transaction will

trigger an overdraft fee and is given an opportunity to cancel the transaction. If this is not feasible for a particular type of transaction, the savings association should allow consumers the choice to make access to the overdraft protection program unavailable by transaction type.

For savings associations interested in further reading on the subject of best practices, OTS recommends an American Bankers Association publication entitled, "Overdraft Protection: A Guide for Bankers."

The text of the OTS Guidance on Overdraft Protection Programs follows:

#### *OTS Guidance on Overdraft Protection Programs*

The Office of Thrift Supervision (OTS) is issuing this guidance concerning a service offered by savings associations that is commonly referred to as "bounced-check protection" or "overdraft protection." This service is sometimes offered on both consumer and small business transaction accounts as an alternative to traditional ways of covering overdrafts. This guidance is intended to assist savings associations in the responsible disclosure and administration of overdraft protection services, particularly those that are marketed to consumers.

#### *Introduction*

To protect against account overdrafts, some consumers obtain an overdraft line of credit, which is subject to the disclosure requirements of the Truth in Lending Act (TILA). If a consumer does not have an overdraft line of credit, the institution typically returns the check as unpaid and charges the consumer a nonsufficient funds or "NSF" fee. Some institutions may accommodate the consumer and pay overdrafts on a discretionary, ad-hoc basis. Regardless of whether the overdraft is paid, institutions typically charge the NSF fee when an overdraft occurs. Over the years, this accommodation has become automated by many institutions. Historically, institutions have not promoted this accommodation. This approach has not raised significant supervisory concerns.

More recently, some depository institutions have offered "overdraft protection" programs that, unlike the discretionary accommodation traditionally provided to those lacking a line of credit or other type of overdraft service (e.g., linked accounts), are marketed to consumers essentially as a convenience or fee for service program.

While the specific details of overdraft protection programs vary from institution to institution and also vary

over time, those currently offered by institutions incorporate some or all of the following characteristics:

- Institutions inform consumers that overdraft protection is a feature of their accounts and advertise the use of the service.

- Coverage is automatic for consumers who meet the institution's criteria (e.g., account has been open a certain number of days, deposits are made regularly). Typically, the institution performs no credit underwriting.

- Overdrafts generally are paid up to the aggregate limit set by the institution for the specific class of accounts, typically \$100 to \$500.

- Institutions with an express aggregate "dollar limit" inform consumers of their limit under the program.

- Many program disclosures state that payment of an overdraft is discretionary on the part of the institution and may disclaim any legal obligation of the institution to pay any overdraft.

- The service may extend to check transactions as well as other transactions, such as withdrawals at automated teller machines (ATMs), transactions using debit cards, pre-authorized automatic debits from a consumer's account, telephone-initiated funds transfers, and on-line banking transactions.

- A flat fee is charged each time the service is triggered and an overdraft item is paid. Commonly, a fee in the same amount would be charged even if the overdraft item were not paid. A daily fee also may apply for each day the account remains overdrawn.

- Some institutions offer closed-end loans to consumers who do not bring their accounts to a positive balance within a specified time period. These repayment plans allow consumers to repay their overdrafts and fees in installments.

#### *Concerns*

Aspects of the marketing, disclosure, and implementation of some overdraft protection programs are of concern to OTS. For example, some institutions have promoted this service in a manner that leads consumers to believe that it is a line of credit by informing them that their account includes an overdraft protection limit of a specified dollar amount without clearly disclosing the terms and conditions of the service, including how fees reduce overdraft protection dollar limits and how the service differs from a line of credit.

In addition, some institutions have adopted marketing practices that appear to encourage consumers to overdraw

their accounts, such as by informing consumers that the service may be used to routinely overdraw their accounts, with little or no analysis of the consumer's creditworthiness. These overdraft protection programs may be promoted in a manner that leads consumers to believe that overdrafts will always be paid when, in reality, the institution reserves the right not to pay some overdrafts. Some institutions may advertise accounts with overdraft protection coverage as "free" accounts and thereby lead consumers to believe that there are no fees associated with the account or the overdraft protection program.

Furthermore, institutions may not clearly disclose that the program may cover instances when consumers overdraw their accounts by means other than check, such as at ATMs and point-of-sale (POS) terminals. Some institutions may include overdraft protection amounts in the figure that they disclose as the consumer's account "balance" (for example at an ATM) without clearly distinguishing the funds that are available for withdrawal without overdrawing the account. Where the institution knows that the transaction will trigger an overdraft fee, such as at a proprietary ATM, institutions also may not alert the consumer prior to the completion of the transaction to allow the consumer to cancel the transaction before the fee is triggered.

Savings associations should carefully weigh the risks presented by the programs. Further, savings associations should carefully review their programs to ensure that marketing and other communications concerning the programs do not mislead consumers to believe that the program is a traditional line of credit or that payment of overdrafts is guaranteed, do not mislead consumers about their account balance or the costs and scope of the overdraft protection offered, and do not encourage irresponsible consumer financial behavior or other behavior that potentially may unacceptably increase risk to the savings association.

#### *Safety & Soundness Considerations*

Overdraft protection programs may expose an institution to a higher level of nonpayment than traditional line of credit programs where the institution has performed appropriate credit underwriting. All overdrafts, whether or not subject to an overdraft protection program, are subject to the safety and soundness considerations contained in this section.

Savings associations providing overdraft protection programs should

adopt written policies and procedures adequate to address the operational, and other risks associated with these types of programs. Prudent risk management practices include the establishment of express account eligibility standards and well-defined and properly documented dollar limit decisions and other criteria. Savings associations also should monitor these accounts on an ongoing basis and be able to identify consumers who do not manage their accounts in a satisfactory manner. Overdraft protection programs should be administered and adjusted, as needed, to ensure that the performance of such programs is satisfactory and in line with expectations. This may include, where appropriate, disqualification of a consumer from future overdraft protection. Reports sufficient to enable management to identify, measure, and manage overdraft volume, profitability, and performance should be provided to management on a regular basis.

Savings associations also are expected to incorporate prudent risk management practices related to account repayment and suspension of overdraft protection services. These include the establishment of specific timeframes for when consumers must pay off their overdraft balances. For example, savings associations should have established procedures for the suspension of overdraft services when the account holder no longer meets the eligibility criteria (such as when the account holder has declared bankruptcy or defaulted on a loan at the savings association) as well as for when there is a lack of timely repayment of an overdraft. In addition, overdraft balances, including uncollected fees, should generally be written off when considered uncollectible, but no later than 60 days from the date first overdrawn.

Some overdrafts are rewritten as loan obligations in accordance with an institution's loan policy and supported by a documented assessment of that consumer's ability to repay. In those instances, the overdraft is considered a loan and the delinquency and charge-off timeframes described in the FFIEC Uniform Retail Credit Classification and Account Management Policy apply. See also OTS CEO Memorandum #128 (July 27, 2000) ("Revised Uniform Retail Credit and Account Management Policy"), available at <http://www.ots.treas.gov/docs/2/25128.pdf>.

With respect to the reporting of income and loss recognition on overdraft protection programs, savings associations should follow generally accepted accounting principles (GAAP).

OTS expects all savings associations to adopt rigorous loss estimation processes to ensure that overdraft fee income is accurately measured. Such methods may include providing loss allowances for uncollectible amounts or fees or, alternatively, only recognizing that portion of earned fees estimated to be collectible.

Savings associations entering into overdraft protection contracts with third-party vendors must conduct thorough due diligence reviews prior to signing a contract. The interagency guidance contained in the Outsourcing Technology Services Booklet part of the FFIEC's IT Examination Handbook, outlines OTS's expectations for prudent practices in this area. See also OTS CEO Memorandum #201 (July 15, 2004), available at <http://www.ots.treas.gov/docs/2/25201.pdf>.

#### *Best Practices*

Clear disclosures and explanations to consumers of the operation, costs, and limitations of an overdraft protection program and appropriate management oversight of the program are fundamental to enabling responsible use of overdraft protection. Such disclosures and oversight can also minimize potential consumer confusion and complaints, foster good customer relations, and reduce credit, legal, and other potential risks to the savings association. Savings associations that establish overdraft protection programs should, as applicable, take into consideration the following Best Practices, many of which have been recommended or implemented by financial institutions and others, as well as practices that may otherwise be required by applicable law. While OTS is concerned about promoted overdraft protection programs, the Best Practices may also be useful for other methods of covering overdrafts. These Best Practices currently observed in or recommended by the industry include:

#### *Marketing and Communications With Consumers*

- *Avoid promoting poor account management.* Savings associations should not market the program in a manner that encourages routine or intentional overdrafts; rather present the program as a customer service that may cover inadvertent consumer overdrafts.

- *Fairly represent overdraft protection programs and alternatives.* When informing consumers about an overdraft protection program, inform consumers generally of other overdraft services or credit products, if any, that are available at the savings association and how the terms, including fees, for

these services or products differ. Identify for consumers the consequences of extensively using the overdraft protection program.

- *Train staff to explain program features and other choices.* Train customer service or consumer complaint processing staff to explain their overdraft protection program's features, costs, and terms, including how to opt out of the service. Staff also should be able to explain other available overdraft products offered by the savings association and how consumers may qualify for them.

- *Clearly explain the discretionary nature of program.* If payment of an overdraft is discretionary, make this clear. Savings associations should not represent that the payment of overdrafts is guaranteed or assured if the savings association retains discretion not to pay an overdraft.

- *Distinguish overdraft protection services from "free" account features.* Savings associations should not promote "free" accounts and overdraft protection services in the same advertisement in a manner that suggests the overdraft protection service is free of charges.

- *Clearly disclose program fees.* In communications about overdraft protection programs, clearly disclose the dollar amount of the fee for each overdraft and any interest rate or other fees that may apply. For example, rather than merely stating that the savings association's standard NSF fee will apply, savings associations should restate the dollar amount of any applicable fees or interest charges.

- *Clarify that fees count against the disclosed overdraft protection dollar limit.* Consumers should be alerted that the fees charged for covering overdrafts, as well as the amount of the overdraft item, will be subtracted from any overdraft protection limit disclosed.

- *Demonstrate when multiple fees will be charged.* If promoting an overdraft protection program, clearly disclose that more than one overdraft fee may be charged against the account per day, depending on the number of checks presented and other withdrawals made from the consumer's account.

- *Do not manipulate transaction-clearing rules.* Transaction-clearing rules (including check-clearing and batch debit processing) should not be

administered unfairly or manipulated to inflate fees.

- *Explain the impact of transaction-clearing policies.* Clearly explain to consumers that transactions may not be processed in the order in which they occurred and that the order in which they are received by the savings association and processed can affect the total amount of overdraft fees incurred by the consumer. Savings associations should also clearly disclose rules for processing and clearing transactions.

- *Illustrate the type of transactions covered.* Clearly disclose that overdraft protection fees may be imposed on transactions such as ATM withdrawals, debit card transactions, preauthorized automatic debits, telephone-initiated transfers, or other electronic transfers, if applicable, to avoid implying that check transactions are the only transactions covered.

#### Program Features and Operation

- *Provide election or opt-out of service.* Obtain affirmative consent of consumers to receive overdraft protection. Alternatively, where overdraft protection is automatically provided, permit consumers to "opt out" of the overdraft program and provide a clear consumer disclosure of this option.

- *Alert consumers before a transaction triggers any fees.* When consumers attempt to withdraw, transfer, or otherwise access funds made available through an overdraft protection program (other than by check), savings associations should alert consumers that completing the transaction will trigger an overdraft protection fee. Savings associations should also give consumers an opportunity to cancel the attempted transaction. If this is not feasible for a particular type of transaction, then savings associations should allow consumers the choice to make access to the overdraft protection program unavailable by transaction type, even if it results in limiting access to the overdraft protection amount only to check transactions.

- *Prominently distinguish balances from overdraft protection funds availability.* When disclosing a single balance for an account by any means, savings associations should not include overdraft protection funds in that

account balance. The disclosure should instead represent the consumer's own funds available without the overdraft protection funds included. If more than one balance is provided, separately (and prominently) identify the balance without the inclusion of overdraft protection.

- *Promptly notify consumers of overdraft protection program usage each time used.* In addition to any alert at the time of transaction, promptly notify consumers when overdraft protection has been accessed, for example, by sending a notice to consumers the day the overdraft protection program has been accessed. The notification should identify the date of the transaction, the type of transaction, the overdraft amount, the fee associated with the overdraft, the amount necessary to return the account to a positive balance, the amount of time consumers have to return their accounts to a positive balance, and the consequences of not returning the account to a positive balance within the given timeframe. Notify consumers if the savings association terminates or suspends the consumer's access to the service, for example, if the consumer is no longer in good standing.

- *Consider daily limits on fees imposed.* Consider providing a daily cap on overdraft fees charged against any one account, while continuing to provide coverage for overdrafts up to the overdraft limit.

- *Monitor overdraft protection program usage.* Monitor excessive consumer usage, which may indicate a need for alternative arrangements or other services and inform consumers of these available options.

- *Fairly report program usage.* Savings associations should not report negative information to consumer reporting agencies when the overdrafts are paid under the terms of overdraft protection programs that have been promoted by the savings association.

This concludes the text of the OTS Guidance on Overdraft Protection Programs.

Dated: February 15, 2005.

By the Office of Thrift Supervision

**James E. Gilleran,**  
Director.

[FR Doc. 05-3195 Filed 2-17-05; 8:45 am]

BILLING CODE 6720-01-P