



State of Washington

Department of Financial Institutions

GUIDANCE AND BEST PRACTICES FOR OVERDRAFT PROTECTION PROGRAMS

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Table of Contents

	<u>Page No.</u>
1.0 Introduction	1
2.0 Customer Education	1
3.0 Advertising/ & Marketing	1
4.0 “Automatic Eligibility”	2
5.0 Internal Decision-Making Policies	3
6.0 Notification & Terms of Overdraft Protection	3
7.0 Disclosure of Balance	4
8.0 ATM Cash Withdrawals	4
9.0 Opt-Out	5
10.0 Notification of Overdrafts	5
11.0 Amount and Disclosure of Overdraft Fees	5
12.0 “Dollar Limits” of Overdraft Protection Programs	6
13.0 Pay/No Pay Decisions	6
14.0 Order of Payment of Overdrafts	7
15.0 Suspension of Overdraft Protection	7
16.0 Third Party Vendors	8
APPENDIX: Definition of Overdraft Protection Programs	9

1.0 Introduction

On June 18, 2003, the Department of Financial Institutions (DFI) issued an examination by questionnaire to Washington state-chartered financial institutions¹ regarding their use of Overdraft Protection Programs². After compiling the results of the Examination Questionnaire, the Department found that, in general, state-chartered institutions have acted reasonably and responsibly when offering Overdraft Protection Programs. However, there are some areas where these institutions can improve.

What is Guidance? The following Guidance outlines what the Department views as features of a safe and sound Overdraft Protection Program that provides adequate consumer protection. While the Guidance does not have the force of law, it expresses the Department's view of what each state-chartered institution should strive to achieve.

What is a Best Practice? We have also provided with this Guidance some examples of Best Practices by Washington state-chartered institutions. A Best Practice is a positive example for state-chartered institutions that addresses certain issues of an Overdraft Protection Program. The Best Practices outlined below reflect actual practices of certain institutions – not hypotheticals. In some instances, the Best Practices may exceed the standards set forth in the Guidance.

The Department expects financial institutions to consider the Guidance when developing and maintaining Overdraft Protection Programs. In addition, the Department believes the Best Practices may help foster even greater responsibility to the public in the offering of Overdraft Protection Programs.

Please direct any questions about this Guidance and the Best Practices to Division of Banks (360) 902-8704 or Division of Credit Unions (360) 902-8701 or e-mail questions to comments@dfi.wa.gov

2.0 Customer³ Education

2.1 Guidance

- 2.1.1 Customer Education. DFI encourages institutions to inform customers of the risks and consequences of relying on this product, and the costs and benefits of various alternatives for short-term customer borrowing (e.g., transferring from savings, lines-of-credit, and credit cards).

3.0 Advertising & Marketing

3.1 Guidance

- 3.1.1 No Misleading Advertising or Marketing. If you market these programs your advertising should not be misleading to the reasonable consumer. This can be accomplished by adhering to the following general Guidance.

¹ The word "institution" is used interchangeably for a bank, thrift, or credit union.

² The definition of "Overdraft Protection Program" is specific for this Guidance and can be found in the Appendix.

³ The word "customer" is used interchangeably for "credit union member."

- Key Elements of the Program Should Be Clear. Advertising and marketing should contain key elements of the Program and should be designed to allow the customer to understand his/her options. Such materials should not be inconsistent with terms provided in disclosure documents. (See section 6.1.1.)
- Discretionary Service. Advertising and marketing should be clear that payment of the overdraft is a discretionary service and not automatic.
- Refrain from Misleading “Overselling”. Advertising and marketing should refrain from statements that oversell the benefits of Overdraft Protection and give the wrong impression about the scope of its protection. Statements such as the following should be avoided:
 - ✓ “No more charges from retailers for insufficient checks.”
 - ✓ “Make a mistake -- you’re covered.”
 - ✓ “Write a check or use an ATM for more than you have in the Bank -- you’re covered.”
 - ✓ “Money may not grow on trees, but here’s the next best thing.”

3.2 Best Practices

- 3.2.1 One institution stood out as exhibiting best practices for advertising and marketing. The institution:
- Promotes its Overdraft Protection Program as being available when customers’ checking accounts are accidentally overdrawn.
 - States clearly that any current overdraft arrangements will remain in place, with the Overdraft Protection Program only being activated if there are insufficient funds available from all other arranged accounts.
 - States clearly the overdraft limit and associated overdraft fee.
 - Sets a clear expectation for repayment within 30 days or collection processes begin.
 - Provides an opt-out notice.

4.0 “Automatic” Eligibility

4.1 Guidance

- 4.1.1 Notify When “Automatically” Added to Account. A customer should not first learn about the Overdraft Protection Program when s/he receives her/his first overdraft notification letter. The institution should promptly notify the customer and provide full disclosure of the Program (1) when the account is opened or (2) when the customer meets the “automatic eligibility” requirements.
- 4.1.2 Opt-out. (See section 9.0.)

5.0 Internal Decision-Making Policies

5.1 Guidance

- 5.1.1 Consistent Eligibility Requirements. Eligibility requirements should be consistently applied. The customer should be generally informed of eligibility requirements at account opening.
- 5.1.2 Fair Lending Concerns. Even though Overdraft Protection may be exempt from the Truth-in-Lending Act (TILA), this “discretionary service” may nonetheless constitute “credit” within the meaning of the Equal Credit Opportunity Act (ECOA), at 15 USC, section 1691a. Moreover, if credit scoring for eligibility purposes is applied in a manner that would result in a discriminatory “effect,” an institution may face potential liability for such credit scoring, however well intentioned it may be. Although there is nothing discriminatory about credit scoring *per se*, we caution institutions to be watchful of their internal eligibility procedures -- particularly because *intent* to discriminate is not a requisite of a “fair lending” claim.

6.0 Notification & Terms of Overdraft Protection

6.1 Guidance

Despite some good to very good practices as noted in section 6.2, all institutions can improve upon their disclosures, both as to clarity and/or specificity of all terms. This is true of brochures, deposit contracts and other disclosures.

- 6.1.1 Complete Disclosure. There should be complete disclosure of all terms of Overdraft Protection at account set up or when the customer meets “automatic eligibility” requirements. Disclosures should be clear, concise, easy to read, and include the following elements:
- How the program may be used.
 - Any restrictions imposed by the institution.
 - Eligibility.
 - Notice.
 - Overdraft limits.
 - Repayment.
 - Costs/Fees.
 - The discretionary nature of the institution’s decision to honor an overdraft.
 - Method to contact the institution if the customer has questions.
 - Rights and methods to opt-out.
- 6.1.2 Deposit Contract or Rules of Account. All terms of Overdraft Protection should be set forth in a separate section in the Deposit Contract or Rules of Account (or equivalent), both textually and in any table of contents or index.
- 6.1.3 Avoid Misleading Customers About Overdraft Limits. An institution should not mislead customers about the extent of overdraft limits.

6.2 Best Practices

- 6.2.1 Deposit Contract is Inadequate as Sole Information Medium. Deposit contracts and rules are often difficult to read. Several institutions assist customers in understanding the program by providing a brochure. One institution provides a brochure that contains the following worthy elements in simple, lay language:
- 6.2.1a Distinguishes its true overdraft protection product, "Overdraft Limit" from other products such as "OD Line of Credit" and "OD Transfer Service."
 - 6.2.1b Repeatedly and clearly emphasizes the service is "discretionary" and not "automatic."
 - 6.2.1c Reminds the customer of his/her responsibility to record all balances and transactions (including check card purchases, ATM withdrawals, electronic bill payments or other automatic transactions) and to maintain sufficient funds within his/her account.
 - 6.2.1d Provides a customer service hotline for additional information or to have the brochure explained by a customer service representative.
- 6.2.2 Providing Web Information. Many institutions make good use of their respective Web sites to disclose information about Overdraft Protection.

7.0 Disclosure of Balance

7.1 Guidance

- 7.1.1 Available Balance. Institutions should not include the Overdraft Protection amount in the available balance. The available balance disclosed to the customer should be the amount the customer can withdraw without overdrawing the account, i.e. the actual balance. The customer should receive the same available balance amount no matter what service is being used (e.g., teller inquiry, ATM screen, on-line banking, debit card transaction, or telephone transfer).

8.0 ATM Cash Withdrawals

8.1 Guidance

- 8.1.1 Notice on Institution-Owned or -Controlled ATM Screens. Institutions should include a notice on their owned or controlled ATMs that the customer views prior to completion of a transaction. The notice should explain to the customer that completion of the transaction may result in an overdraft and the customer may incur an overdraft fee.
- 8.1.2 Notice on Other ATM Screens. The Department encourages institutions to inquire of their ATM service providers as to the availability of additional disclosures regarding overdraft fees on ATM screens.

9.0 Opt-Out

9.1 Guidance

- 9.1.1 Notice of Opt-Out Privilege at Account Set-Up. Customers should be informed at the time they qualify for protection that they may opt-out. Customers should be informed of the consequences of opting-out, and any alternatives to Overdraft Protection Programs.
- 9.1.2 Timing & Methods of Opting-Out. Customers should be able to opt-out of the Program at any time by a clearly defined method disclosed in the deposit contract.

10.0 Notification of Overdrafts

10.1 Guidance

- 10.1.1 Universal Notification. Institutions should send written notification to the customer within one to two business days of payment of an item causing an overdraft.
- 10.1.2 Contents of Notification. Written notification should include the following: amount of overdraft(s), date of overdraft(s), associated fees, required amount to be repaid, required time of repayment, and a number to call, or a website or e-mail address to contact if the customer has questions.
- 10.1.3 Follow-up Letters. Institutions should send one or more follow-up letters when the account remains overdrawn. The notice should contain the date by which the overdraft amount must be repaid to remain eligible for the Overdraft Protection Program.

10.2 Best Practice

- 10.2.1 Contact by Phone. Some institutions contact the customer by telephone the same day the overdraft occurs.

11.0 Amount & Disclosure of Overdraft Fees

11.1 Guidance

- 11.1.1 Additional Charges/Interest. These charges include daily interest or periodic fees exceeding what an institution imposes as an overdraft protection fee. [For example, charging \$3 per day when the customer has a negative balance, or charging interest after 3 business days at prime rate plus two percent.] Currently, federal regulators are reviewing whether or not such fees are finance charges and subject to disclosure under Regulation Z, 12 CFR, section 226.4(b)(2). As a result of these concerns, DFI cautions institutions not to impose additional charges/interest over and above their Overdraft Protection Program fee.

11.1.2 Overdraft Protection Program Fees in Excess of NSF Fees. Overdraft protection fees exceeding the amount of NSF fees may trigger finance charge disclosure requirements contained in Regulation Z, 12 CFR, section 226.4(b)(2). As a result of these concerns, DFI cautions institutions not to impose overdraft protection fees in excess of NSF fees.

11.1.3 Truth in Savings Disclosures. All overdraft protection fees and charges in connection with a deposit account must be disclosed in order to be in compliance with the Truth in Savings Act and Regulation DD (12 USC, section 4301 et seq. and 12 CFR, part 230.1). [Note: If the service is to be implemented after account opening, the notice of fees, if given at a later time, must meet all applicable notice of change requirements under such regulations.]

11.2 Best Practice

11.2.1 Maximum Daily Fee Limits. A number of institutions have established reasonable limits on the amount of overdraft fees assessed per day.

Example: One institution has a daily limit of four fees at \$18 per overdraft item. If the customer has six overdrafts on the same day, the institution will charge \$72 total in fees (\$18 times 4 items). The items in excess of four on that same day are paid as overdrafts up to the customer's overdraft protection limit, but no fee is charged for overdraft items in excess of four per day. Chronic users of excessive overdrafts have their overdraft limit suspended or the checking account closed, based on the institution's written policy in the Overdraft Protection Program disclosures.

12.0 "Dollar Limits" of Overdraft Protection Program

12.1 Guidance

12.1.1 Consistent Requirements. The amount of protection should be based on a consistent and standard set of factors.

12.1.2 Increasing Limits Based on Account Behavior. Institutions should place reasonable initial dollar limits per account. Increases in the dollar limits should be approved based on the customer's ability to handle the increased limit, an analysis of account activity, and an analysis of risk. Institutions should not raise the limits for the primary purpose of increasing the volume of NSF's per customer account.

13.0 Pay/No Pay Decisions

13.1 Guidance

13.1.1 Consistent Objective Methods for Honoring Overdrafts. Institutions should have consistent objective methods for their Overdraft Protection approval process, whether automated or having personnel review the transactions.

14.0 Order of Payment of Overdrafts

14.1 Guidance

- 14.1.1 No Change in Order. Institutions should not change the order in which items are honored for the purpose of increasing the number of items that would overdraw an account.
- 14.1.2 Disclosure. Institutions should clearly disclose to their customers the order in which items will be paid.

15.0 Suspension of Overdraft Protection

15.1 Guidance

- 15.1.1 Disclosure of Grounds for Suspension. Reasons for suspension/cancellation of Overdraft Protection should be clearly disclosed to the customer. Such reasons may include: failing to bring accounts to a positive balance within xx days; filing for bankruptcy protection; delinquency of a loan account; or illegal activity such as check kiting.
- 15.1.2 Notification of Suspension. Customers should be notified in writing when protection is suspended/cancelled.
- 15.1.3 Consistent Application of Suspension Rules. Rules for suspension/cancellation of Overdraft Protection should be applied consistently based on specific, identified criteria.

15.2 Best Practices

- 15.2.1 Warning before Suspension. One institution provides the following after an account has been overdrawn for five consecutive days: a letter is mailed instructing the customer to immediately bring his or her account to good standing. If the account is not brought to good standing within the next five days, transactions on the account will not be honored (because the Overdraft Limit will be suspended). After ten consecutive days, another letter is sent instructing the customer to immediately bring his or her account to good standing. This letter also notifies the customer that transactions on his or her account will not be honored (because the Overdraft Limit has been suspended). Once Overdraft Limit is suspended, it no longer appears on the periodic statement.
- 15.2.2 Consistent Terms for Suspension. At some institutions if a checking account remains negative for more than 10 days, the customer is notified by letter that overdraft privileges are revoked.

16.0 Third Party Vendors

16.1 Guidance

16.1.1 Third-Party Risk. The Office of the Comptroller of the Currency (OCC) has previously issued guidance as to risks in dealing with a third-party vendor of Overdraft Protection, which this Department, in principle, endorses.

16.1.1a No Third-Party Sharing of Risk/Due Diligence of Vendor. It often appears that the arrangement an institution enters into with a vendor to participate in an Overdraft Protection Program is devised in such a manner that only the institution is subject to the credit and reputation risk, while the vendor shares the benefits (i.e., the income). Institutions should 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 vendor can fulfill the representations as outlined in the contract. Requirements for the timing and quality of financial information should be set forth in the vendor's contract.

16.1.1b Lock-In (Anti-Termination) Clauses. Beware of contracts with a termination clause that prohibits or severely restricts the contracting institution's ability to terminate once a Program is initiated. In one such contract, only the vendor has control of termination, and the only termination consideration is if the 150% fee income profitability goal is not achieved. Such a one-sided termination clause would be potentially detrimental for an institution from a reputation, financial, and strategic risk perspective. Under such a contract, the institution would have no recourse if it became dissatisfied for a variety of reasons, such as customer satisfaction, institution reputation, and credit risk issues (e.g., 50% of the customers complain or 15% delinquency rate).

APPENDIX: Definition of Overdraft Protection Programs

Typically, Overdraft Protection Programs generate fee income by covering overdrafts up to a specified predetermined limit. These programs differ from traditional overdraft programs because they are automated and the customer does not obtain prior credit approval for the program; nor does the program utilize a credit card, line of credit, or savings account in order to cover the overdraft.

Although there are many variations of Overdraft Protection Programs, most programs have the following standard features:

- Financial institutions make the program available to customers whose account is in “good standing.” Financial institutions define “good standing” differently. For example, “good standing” may be defined as an account that has been open for 30 to 60 days with regular deposits made to the account, or it may be defined as an account where the customer makes regular deposits and the account has a positive balance at least once every 20 days.
- The customer receives some type of overdraft protection coverage with a dollar limit. The predetermined limits range from \$100 to \$1,000.
- Customers usually do not apply for these programs or sign anything to apply for the programs.
- Customers gain access to the programs through:
 - ❖ Checks and other withdrawals at teller windows;
 - ❖ ATM cards or Debit cards (for example Visa, Check Card);
 - ❖ ACH withdrawal transactions;
 - ❖ Checks issued to a third party;
 - ❖ Online banking or a voice banking line;
 - ❖ Debit and point of sale transactions;
 - ❖ Any other debit transactions honored through a personal checking account.
- Customers are charged an overdraft fee for each payment made by the financial institution up to the program limit. In addition, some institutions may charge other fees including daily overdraft fees.
- Customers are required to bring their account to a positive balance at least once in a stated time period (for example, once every 20 or 30 days). There are varied consequences if an account is not brought to a positive balance. For instance, some institutions close the account and revoke the privilege, while others revoke only the privilege.