

FDIC OVERDRAFT PAYMENT PROGRAM SUPERVISORY GUIDANCE FREQUENTLY ASKED QUESTIONS

FDIC staff has developed the following Frequently Asked Questions (FAQs) and answers in response to questions from supervised institutions and third-party vendors about the FDIC's Overdraft Payment Supervisory Guidance issued in November 2010 (FIL-81-2010) (Guidance). The responses represent the views and opinions of FDIC staff regarding incorporation of the Guidance into the examination process.

I. DEFINING AUTOMATED AND AD HOC PROGRAMS

1. How does an “automated” overdraft payment program differ from “ad hoc” overdraft payment practices?

Automated overdraft payment programs typically rely on computerized decision-making, and use pre-established criteria to pay or return specific items. There is little to no case-by-case review and decision-making with respect to an individual customer or item.

By contrast, *ad hoc* practices typically involve the exercise of bank employee judgment in making a specific decision about whether to pay or return an item. This is done as an accommodation and based on the employee's knowledge of a particular customer.

2. Do the specific supervisory expectations about customer contact apply to ad hoc overdraft payments?

No. The FDIC's November 2010 Guidance is focused on assisting institutions in identifying, managing, and mitigating the particular risks posed by automated overdraft payment programs. Ad hoc overdraft payments have been authorized by banks for years as an accommodation based on specific considerations and knowledge of a particular customer, and they have generally not been the subject of the type of product over-use concerns that can be associated with automated overdraft programs. Consequently, the specific supervisory expectations set out in the Guidance regarding customer contact for excessive or chronic users of automated overdraft payment programs do not apply to ad hoc overdraft practices.

3. Should institutions monitor and manage risks associated with ad hoc payments of overdrafts?

Yes. While the Guidance's specific supervisory expectations relate only to automated overdraft payment programs, institutions that authorize overdrafts on an ad hoc basis should manage potential reputational, compliance, and litigation risks regarding certain overdraft payment practices, such as check clearing practices designed to maximize

overdraft fees. In addition, the Guidance provides updated information on the laws, regulations, and other guidance that apply to all types of overdraft payment practices and programs.

II. EXCESSIVE USE AND MEANINGFUL FOLLOW-UP

- 1. The Guidance states that FDIC-supervised institutions should monitor programs for excessive or chronic customer use, and if a customer overdraws his or her account on more than six occasions where a fee is charged in a rolling twelve-month period, undertake meaningful and effective follow-up action. What is an “occasion” where a fee is charged?**

An “occasion” occurs each time an overdraft transaction generates a fee. For example, this would include a per-transaction overdraft fee or a daily fee for an outstanding overdraft status. As a result, potentially more than one “occasion” can occur per day. If three overdraft fees are charged as a result of three transactions (even if the fees are aggregated), that would constitute three occasions. If a fee itself triggers an overdraft, that event would count if a further overdraft fee is charged as a result.

By contrast, overdraft items paid where no fee is charged (for example, if a bank pays an item after a daily limit is met on overdraft items paid and the bank waives additional fees) would not be included. Thus, if four overdrafts occur in a day but the bank only charges three fees as a result of a per-day limit on fees charged, this would constitute three occasions.

- 2. What is meaningful and effective follow-up for chronic or excessive use and how can an institution demonstrate it has made meaningful efforts to reach chronic or excessive users of automated overdraft payment programs?**

Meaningful and effective follow-up means that the institution has made reasonable efforts to provide the customer with information on alternatives to overdraft payment programs that may be better-suited to the individual’s need for short-term credit, as well as a clear mechanism for the customer to avail himself or herself of those alternatives. The key goal is to ensure that customers are able to make informed choices among available options to manage recurring needs for short-term credit. The FDIC will assess the institution’s level of effort to reach customers, the institution’s program for providing notice to customers of available alternatives, and the ease with which customers are able to select alternative products.

Institutions may employ a variety of techniques, based on individual customer profiles and general business practices, to contact excessive or chronic users of overdraft payment programs. For example, the institution’s overall approach could incorporate contacting a

customer via telephone, in person, by mail, or through electronic notifications. Relevant factors include whether the institution:

- Has a regular program to inform excessive or chronic users of overdraft usage and cumulative costs in a prominent or conspicuous fashion;
- Highlights availability of alternatives to overdraft payment programs that may be lower-cost or more appropriate; and
- Provides a clear and simple manner to contact the institution to discuss available alternatives.

The institution should be able to demonstrate that it monitors account usage, undertakes programs designed to address excessive or chronic use, and monitors its success in informing frequent users of overdraft payment programs of the high cumulative costs of the program and the availability of less-costly or otherwise more appropriate alternatives.

Two examples of ways in which an institution could demonstrate meaningful and effective follow-up regarding excessive or chronic users of overdraft programs are to provide *enhanced periodic statements* or employ a *targeted outreach approach*. Specific information discussing meaningful and effective follow-up when utilizing these approaches is described in the attached Illustrations. Institutions may employ other approaches for engaging in effective and meaningful follow-up with chronic or excessive users.

III. FEE LIMITS AND MAXIMIZING FEES

1. What is an example of an appropriate daily limit on overdraft fees?

Daily limits can help prevent a customer's individual lapse in financial management from triggering a cascade of overdraft fees, and will be reviewed as one possible element of the institution's overall approach for addressing chronic or excessive use of automated overdraft payment programs. For example, some institutions have implemented limits on the number of transactions that will be subject to a fee (*e.g.*, no more than three per day) or on total allowable fees (*e.g.*, a specific maximum dollar amount of allowable fees per day).

2. What is an example of an appropriate *de minimis* overdraft amount?

Institutions should consider the use of a *de minimis* threshold before an overdraft fee is charged in order to reduce reputational risk related to charging fees that are disproportionate to the item being cleared. For example, some institutions have implemented *de minimis* limits whereby they do not charge overdraft fees for underlying transaction amounts of less than \$10, while some have declined to charge overdraft fees for transactions of any amount that overdraw an account by less than \$10.

3. What is a reasonable and proportional overdraft fee?

As noted in FAQ # III.2 (*de minimis*), institutions may increase reputational risk when overdraft fees are significantly greater than the amount of the item being cleared. Institutions should review the amount charged for the overdraft payment compared to the amount of the underlying transaction that triggered the overdraft, and assess whether the charge is reasonable and proportionate in comparison. Institutions should consider *de minimis* limits to reduce the reputational risk of overdraft fees that are disproportionate to the cost of the underlying transaction.

4. How can institutions and their third-party vendors work to process transactions in a manner that addresses risks identified in the Guidance?

Transactions should be processed in a neutral order that avoids manipulating or structuring processing order to maximize customer overdraft and related fees. Examples of a neutral order include order received, check number, serial number sequence, or other approaches when necessary based on sound business justification.

Re-ordering transactions to clear the highest item first is not considered neutral because this approach will tend to increase the number of overdraft fees. By contrast, processing batches of transactions in a random order or order received is a neutral approach; however, institutions should not arrange the order of types of transactions (*i.e.*, batches) cleared in order to increase the number of overdrafts and maximize fees.

IV. OTHER QUESTIONS

1. Is an institution required to provide new alternatives to automated overdraft payment programs?

No. Banks are not required to develop new products in response to the Guidance. However, most banks offer some form of short-term alternative, including lines of credit, fixed-term small dollar loans, and linked savings accounts, and the FDIC encourages institutions to provide linked accounts or responsible, short-term credit products (such as those offered under the FDIC's small dollar loan pilot). Banks are expected to inform excessive or chronic users of overdraft payment programs about alternative products that the institution has available for its customers, and to make these programs available to customers that qualify. Such products may qualify for CRA consideration under the service or lending tests.¹

¹ See *Affordable Small Dollar Loan Guidelines*, FIL-50-2007 (June 19, 2007), available at: <https://www.fdic.gov/news/inactive-financial-institution-letters/2007/fil07050.html>, and *Interagency Questions and Answers Regarding Community Reinvestment*, 75 Fed. Reg. 11642 (Mar. 11, 2010), available at: <http://www.ffiec.gov/cra/pdf/2010-4903.pdf>.

2. Is an institution required to terminate or suspend a customer's access to the automated overdraft payment program if the customer engages in chronic or excessive use?

No. Institutions are expected to monitor usage and engage in meaningful and effective follow-up to inform excessive users of available alternatives. However, as discussed in the Guidance, a number of risks are associated with chronic or excessive use of automated overdraft programs, including reputational, compliance, safety-and-soundness, and litigation risks. If such risks are identified during the course of an institution's monitoring and oversight of an automated overdraft program, institutions should take appropriate action to mitigate risks, as has been the case in the past.

3. The Guidance states that the FDIC believes institutions should allow customers to decline overdraft coverage (*i.e.*, opt-out) for payment of overdrafts resulting from non-electronic transactions such as paper checks or automated clearing house (ACH) transfers. Can you clarify to which transactions this recommendation applies?

To promote consumer choice and awareness, institutions are encouraged to permit customers to decline overdraft coverage (*i.e.*, opt-out) for transactions that are not subject to the Regulation E opt-in requirements, including checks, ACH transactions and recurring debits. As part of an institution's on-going relationship with its customers, the FDIC recommends that institutions consider occasional communications to remind customers of available options to terminate overdraft coverage.

4. How can small or rural institutions provide information about financial education?

In addition to educational resources identified in the Guidance, institutions may want to consider using Web-based resources or referrals to reputable, non-profit organizations.

5. When are institutions expected to have reviewed and responded to the Guidance?

As stated in the Guidance, the FDIC expects that institutions will have approved, responsive compliance and risk management action plans, policies and procedures by July 1, 2011.

MEANINGFUL AND EFFECTIVE FOLLOW-UP ILLUSTRATIONS

The following information is provided to illustrate two examples of ways in which institutions may demonstrate meaningful and effective follow-up with excessive or chronic users of overdraft payment programs.

An *enhanced periodic statement approach* would involve augmenting existing, required disclosures for overdraft fees under Regulation DD (Truth in Savings), which requires disclosure of the total amounts of fees charged for overdrafts during the statement period and calendar year-to-date, by prominently highlighting how excessive or chronic users of automated overdraft programs could contact the institution to discuss available alternatives, and encouraging meaningful and effective contact.

A *targeted outreach approach* would involve contacting excessive users in person or via telephone to discuss less costly alternatives to automated overdraft payment programs.

Approach #1: Enhanced Periodic Statements

If an institution chooses to take an *enhanced periodic statement approach* that augments the requirements of Regulation DD for overdraft fees charged during the current statement period and calendar year-to-date, and if a customer incurs more than six overdrafts in a rolling twelve-month period, an institution could include a message on the periodic statement that describes how the customer could contact the institution to discuss alternative options. An effective approach could be to include the name or names of specific employee(s) who have knowledge of alternative credit products for which the customer might qualify and are able to assist the customer in determining whether he or she qualifies for them. For example, the following statement could be used: **“You have been paying multiple overdraft fees and there may be cheaper alternative products that may be better suited for your needs. Please call [name of employee] at xxx-xxx-xxxx to discuss other options with a customer service representative or visit us at your local branch.”**

Under this approach, it would be reasonable for an institution to continue to send enhanced periodic statements to a customer for as long as the customer continues chronic or excessive usage.

Approach #2: Targeted Outreach

If an institution chooses to take a *targeted outreach approach*, an institution would initiate outreach within a reasonable time period (*e.g.*, 30 days) when a customer incurs more than six overdrafts in a rolling twelve-month period, to discuss overdraft usage and available alternatives to the overdraft payment program. If a customer decides to remain in the automated overdraft payment program, the institution should also engage the customer to determine the customer’s preferences for future contact regarding

participation in the automated overdraft payment program. Absent an indication of customer preference regarding subsequent contact, a *targeted outreach approach* would involve contacting a customer whenever there is a cycle of repeated, excessive use (e.g., subsequent occurrences of more than six overdraft occasions where a fee is charged in a rolling twelve-month period).