

High-Yield Checking Accounts: Know the Rules

In today's low interest-rate environment, many bank customers may be looking to earn higher interest rates on their deposits. In response, some banks are offering high-yield checking accounts to attract the attention of these customers. This article reviews the typical features of high-yield checking accounts, with a focus on specific aspects of disclosure that, based on examiner observations, appear most likely to contribute to customer confusion about these accounts. By providing customers with clear and unambiguous disclosures, banks can minimize the potential for customer dissatisfaction and the potential for violations of laws or regulations.

Typical Features of the High-Yield Account

High-yield accounts typically offer free checking, with no minimum balance requirements, and the potential for earning a high annual percentage yield (APY),¹ provided certain conditions ("qualifiers") are met. *(Note: The APY is not necessarily the same as the advertised interest rate).* Some common qualifiers include engaging in a certain number of debit card transactions monthly (usually 10 to 15 transactions), making at least one direct deposit or Automated Clearinghouse (ACH) payment monthly, enrolling in the bank's online banking program, and agreeing to receive electronic bank statements.

Community banks frequently offer these accounts to attract deposits and compete with larger financial institu-

tions. The accounts permit banks to profit from interchange fee income generated through the use of the debit card. In addition, the electronic bank statement qualifier allows banks to reduce expenses associated with printing and mailing statements, and may reduce future overhead expenses as consumers shift from visiting branches to conducting online transactions.

Many banks cap the balances to which the higher APY will apply to control interest expenses. Therefore, balances above the cap amount do not earn the higher APY even if the qualifiers are met; however, these accounts may still earn an attractive APY when compared to competing financial institutions. To encourage consumers to open these accounts, banks offer a fall-back interest rate (the interest rate consumers earn when the qualifiers are not met), which may be slightly higher than current market interest rates. This rate structure makes these accounts an attractive alternative to traditional personal checking accounts.

As a hypothetical example for illustrative purposes, a bank may offer a personal checking account with a 4.01 percent APY,² which is much higher than the 0.10 percent APY of other banks in its area. To qualify for this higher APY, customers must: a) use their debit card a minimum of 10 times per month; b) make one direct deposit or ACH payment monthly; and c) enroll in online banking. There is no minimum balance requirement as balances below \$25,000 receive the higher interest rate while balances of \$25,000 or more receive an APY of

¹ Section 1030.2(c), formerly Section 230.2(c) of Regulation DD (Truth in Savings) defines *annual percentage yield (APY)* as a percentage rate reflecting the total amount of interest paid on an account, based on the interest rate and the frequency of compounding for a 365-day period and calculated according to the rules in Appendix A of this part.

² Ibid.

1.01 percent if the qualifiers are met each qualification period. Where the qualifiers are **not** met, an APY of 0.25 percent will be applied regardless of the account balance, which is still significantly higher than the interest rate being paid by other banks in the area.

Disclosure Issues Most Frequently Observed with High-Yield Accounts

In a number of instances, FDIC examiners have had concerns about the disclosures or promotional materials associated with high-yield accounts. In such instances, examiners have found the disclosures or promotional materials to be unclear or ambiguous about what customers need to do to earn the higher APY. Where such concerns exist, they may pertain to the Truth in Savings disclosures that explain the account terms, as well as to a bank's advertisements,³ brochures, and promotional materials on its Web

site. If these materials indicate that the higher APY can be obtained by performing a few simple tasks without fully describing the actual steps consumers must take to earn the higher interest rate, there is a potential for customer dissatisfaction and regulatory violations.

For example, the requirement that account holders must make a minimum number of transactions monthly with their debit card may not be about the account holder "using" the debit card a certain number of times, but rather about the minimum number of debit card transactions that must *post* and *settle* during the statement cycle or qualification period. These are different things as there is often a delay between the time an account holder makes a transaction and the time the transaction is posted to the account and settled by the bank. Whether the qualifier for the higher APY will be met depends on whether the minimum number of transactions, as that term is defined, happen *within the statement cycle or qualification period*.

Example: An account holder's statement cycle runs from August 1st to August 31st and the consumer needs ten debit card transactions to meet the qualifier. On August 30th the account holder realizes she has made only five debit card transactions since August 1st. To satisfy the qualifier, she purchases five candy bars (or other small-dollar items) and performs five separate Point-of-Sale (POS) transactions on August 30th. She thinks she has satisfied the ten debit card transactions qualifier, but because these five transactions do not post and settle to the account until two days later, she will be credited with only the five transactions she had prior to the candy bar purchases. The consumer fails to meet the qualifier despite having "used" her debit card ten times during the statement cycle or qualification period.

³ Section 1030.2(b), formerly Section 230.2(b) of Regulation DD defines an *advertisement* as a commercial message, appearing in any medium that promotes directly or indirectly: (1) The availability or terms of, or a deposit in, a new account; and (2) For purposes of §1030.8(a) formerly §230.8(a) and §1030.11 formerly §230.11 of this part, the terms of, or a deposit in, a new or existing account.

High-Yield Checking Accounts

continued from pg. 13

Further complicating the issue is that some banks may disqualify small-dollar purchases made at the end of the month. FDIC examiners have heard anecdotal evidence that banks tell consumers that making several small-dollar purchases at the end of the month to obtain the higher APY is manipulating the system, and will not be tolerated. Consumers have been warned that continuing such behavior could result in their account being closed. However, this behavior and consequences was not disclosed to the consumer at the time the account was opened. Similar confusion can occur with ACH payments.

Example: An account holder pays her monthly gym membership automatically from the account on the last day of each month, but the payment does not post and settle until the first of the next month. Result: the consumer does not meet the ACH qualifier to record the requisite number of transactions within the statement cycle or qualification period.

In both of the above examples, it is important that the bank's promotional materials, Web site, and disclosures do not lead the account holder to believe that the mere occurrence of making the debit card transactions or ACH payment each month would be sufficient to meet the high-yield account qualifier. Clear and conspicuous disclosures that the transactions must post *and* settle during the account statement cycle or qualification period to qualify for a high APY would avoid this potential problem. Disclosure problems also may exist in connection with the account requirement that consumers enroll in online banking and agree to receive monthly statements electronically. Examiners frequently have observed that banks' advertisements and disclosures do not inform account

holders that enrolling in online banking means logging into their online account at least once every month and viewing their periodic statement. This is information that consumers would need to know to ensure they satisfy this qualifier.

Regulatory Concerns

Regulation DD (Truth in Savings) generally (1) governs how banks disclose account terms to consumers at account opening; (2) defines what must be disclosed when subsequent events impact the account; and (3) outlines requirements for promoting accounts. In accordance with Regulation DD, depository institutions are required to make disclosures clear, conspicuous, in writing, and in a form that the account holder may retain.⁴ Ambiguous disclosures may result in violations of various sections of Regulation DD, including: Section 1030.1(b) (formerly 230.1(b)), requiring depository institutions to provide account disclosures that give consumers the ability to make meaningful comparisons among institutions; Section 1030.3(b) (formerly 230.3(b)), requiring that disclosures reflect the terms of the legal obligation of the account agreement between the consumer and the institution; Section 1030.4(b) (formerly 230.4(b)), requiring that account disclosures include, as applicable, information on rates, compounding and crediting, balance information, fees, transaction limitations and bonuses; and Section 1030.8 (formerly 230.8), requiring that advertisements not be misleading, not refer to accounts as "free" or "no cost" if certain fees may be imposed, only state the APY and interest rate, and provide other information if certain triggering terms are present.

⁴ See Section 1030.3(a), formerly Section 230.3(a) of Regulation DD.

When disclosures, Web sites, advertisements,⁵ and promotional brochures are unclear and use ambiguous terminology, they may violate Regulation DD and may be considered an unfair or deceptive act or practice under Section 5 of the Federal Trade Commission Act (Section 5).⁶ Table 1 summarizes the standards for determining whether a practice is unfair or deceptive under Section 5.

Violations involving unfairness or deception are serious because of the potential for consumer harm, as well as reputational risk to the financial institution. In such instances, a bank's compliance rating may be downgraded and formal or informal enforcement actions may be imposed. The FDIC also may require banks to conduct account-level reviews to identify harmed consumers and request restitu-

Table 1

Section 5 of the FTC Act Standards of Unfair or Deceptive Acts or Practices (*)
<p><u>Unfairness</u></p> <ul style="list-style-type: none"> ■ An act or practice is unfair if it causes or is likely to cause substantial injury to consumers. ■ The injury is not reasonably avoidable by the consumer. ■ The unfair act or practice is not outweighed by countervailing benefits to consumers or competition. <p>Public policy also may be considered in determining whether an act or practice is unfair.</p> <p><u>Deception</u></p> <ul style="list-style-type: none"> ■ A representation, omission, or practice must mislead or be likely to mislead the consumer. ■ The consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. ■ The misleading representation, omission, or practice must be material. <p>A deceptive representation can be expressed, implied, or involve a material omission. The key is the overall net impression created by the written disclosures. Fine print may be insufficient to correct misleading text.</p>

(*) All standards for unfairness and deception must be met for a Section 5 violation to occur. Please refer to the following Financial Institution Letters (FILs) for more detailed information: FIL-57-2002 (*Guidance on Unfair or Deceptive Acts or Practices*) and FIL-26-2004 (*Unfair or Deceptive Acts or Practices by State-Chartered Banks*).

⁵ Advertisements take a variety of forms, but some of the more common problems have been observed in lobby advertisements, bank Web sites, third-party created brochures, new account literature, radio scripts, and newspaper advertisements.

⁶ The Consumer Financial Protection Bureau (CFPB) has jurisdiction over insured depository institutions with total assets exceeding \$10 billion with respect to certain consumer laws and regulations, including the Truth in Savings Act and Regulation DD. The CFPB also has authority under Sections 1031 and 1036 of the Dodd-Frank Act to take action against abusive acts or practices including those that are unfair or deceptive. Thus far, the CFPB has not exercised its authority with respect to abusiveness.

High-Yield Checking Accounts

continued from pg. 15

tion be provided to adversely affected consumers. For example, paying the difference between the interest rate that should have been paid compared to what was paid or refunding Automatic Teller Machine (ATM) fees. Restitution can be costly. The FDIC also may require banks to pay civil money penalties, which can be large depending on the seriousness of the violations and the number of harmed consumers.

During compliance examinations, FDIC examiners have identified several common issues with the promotional

materials and disclosures for high-yield accounts that may constitute a violation of Regulation DD or an unfair or deceptive act or practice under Section 5, depending on the specific facts and circumstances. Table 2 lists some of the more common problems noted.

Violations associated with high-yield checking accounts often stem from inadequate coordination between marketing and compliance personnel during the product development, introduction, and marketing phases of a high-yield checking account. Similarly, management may rely too

Table 2

Commonly Observed Issues with High-Yield Checking Account Promotional Materials and Disclosures (*)

Bank advertisements, promotional materials, Web sites, and disclosures may:

- Highlight the highest APY and omit the fall-back APY.
- Provide the highest APY and fall-back APY, but not state the qualifiers to achieve the higher APY.
- State some, but not all of the qualifiers.
- Represent unlimited, free, nationwide ATM access but condition free access, through the Truth in Savings disclosures, on the consumer meeting certain qualifiers and limit ATM fee refunds to a certain number per statement or qualification cycle.
- Omit the qualifier requiring enrollment in online banking and receipt of electronic banking statements or fail to explain how the consumer can enroll. *Enrollment is not always conducted at account opening and consumers may not be aware of how to enroll.*
- Omit the requirement that a consumer must log-on and view electronic banking statements during each statement or qualification cycle.
- Omit the requirement that debit card/POS and ACH transactions must post and settle during the statement or qualification cycle.
- Omit the requirement that debit card/POS transactions must be PIN-based or signature-based.
- Fail to state ATM transactions do not count as debit card transactions.
- Fail to explain qualifiers must be met during a certain period, i.e., statement cycle or qualification cycle, and/or not define the period. *A statement cycle may be from the 20th (a calendar day) of a month to the 20th (a calendar day) of the next month. However, some banks use a "qualification cycle" within which the qualifiers must be met. Qualification cycles may be from the 19th of a month (a business day) to the 18th of the next month (a business day). Because the statement cycle is based on calendar days and the qualification cycle on business days, the two periods may not coincide.*

(*) This list is illustrative and not all-inclusive.

heavily on third parties to ensure the product complies with applicable laws, rules, and regulations and may not involve compliance personnel in this determination. Senior management is responsible for performing proper due diligence to ensure that third-party and in-house products are implemented and administered in accordance with the law. Early involvement of compliance personnel in the origination of both developed and third-party products can greatly reduce the use of ambiguous terminology in describing account terms and qualifiers. Conversely, not involving compliance staff in the development of new products represents a significant weakness in a bank's Compliance Management System (CMS).

As an example of such issues, FDIC compliance examiners have identified problems in high-yield checking account products related to a bank's use of products developed by third parties that initially comply with regulatory requirements, but are then adjusted by the bank's marketing department in an attempt to make the program more attractive to consumers. Third-party products may state that debit card transactions need to post and settle to meet the qualifiers. However, marketing department personnel change the language to state that consumers have to simply "make" or "have" a certain number of debit card transactions per month to meet the qualifiers. Such adjustments, if not monitored and detected by the bank's compliance personnel, could result in violations of consumer protection laws and regulations.

Such issues may reflect a need for the bank to strengthen its compliance program. A proactive compliance program requires the sampling and monitoring of disclosures, advertisements, and promotional materials to ensure potential problems can be addressed early. By periodically sampling and monitoring disclosures, advertisements and promotional materials, the bank's compliance personnel can promptly detect any issues that may cause consumer confusion.

When examining a bank offering a high-yield account, examiners will:

- Closely scrutinize bank advertisements (in all forms) connected with high-yield accounts to determine whether the terms and conditions are disclosed in a manner that is clear and unambiguous for account holders.
- Check the bank's complaints and inquiries to determine whether customers have expressed confusion with the bank's explanation of the qualifiers related to the account. This is often best accomplished by interviewing front-line branch personnel who interact with customers.
- Ensure deposit disclosures clearly and conspicuously define account terms and conditions for the consumer. Terms and qualifiers should be consistent and allow a reasonable consumer to understand them. Examiners should focus on broadly defined terms such as "make," "use," or "have" etc., and how institution management defines them.

High-Yield Checking Accounts

continued from pg. 17

Best Practices

Banks can minimize exposure to violations of consumer protection laws and regulations by incorporating the following best practices into their CMS:

- Involve the compliance officer or compliance consultants in the product development, implementation, and promotional phases of the product;
- Ensure materials contain clear and conspicuous terminology. Define all terms and provide detailed information explaining how to satisfy each qualifier and note any relevant limitations (post and settlement time, qualification cycle, etc.). View materials from the perspective of a “reasonable consumer.”
- Monitor consumer inquiries and complaints for signs that information in disclosures, brochures, Web sites, or promotional materials is unclear. Banks receiving such inquiries or complaints should be proactive and alert their compliance officer that consumers are expressing confusion about account terms. Tracking inquiries and complaints can help banks make modifications to ensure consumers are not misled and that promotions, Web sites, and disclosures conform to all applicable laws and regulations;
- Review training materials and scripts used in promoting accounts, including a review of promotional materials provided by third-party vendors;
- Ensure bank personnel responsible for opening accounts are properly trained in account qualifiers, understand product features, and can clearly convey this information to consumers;
- Clearly state the purpose of the account and disclose examples of inappropriate behavior or account misuse. Identify the ramifications of engaging in such behavior. For example, the bank might state that the account cannot be used for multiple small-dollar POS transactions at the end of the statement cycle to earn the higher APY; and
- Explain (clearly and conspicuously) what happens if the consumer does not meet the qualifiers.

Conclusion

When examiners encounter a bank offering high-yield checking accounts, they will closely review whether the bank’s communications with consumers about these types of products are clear and conspicuous. Bank management should have devoted the time to design and implement accurate and unambiguous promotional materials, Web sites, and disclosures. Banks that invest the time will reduce the likelihood of violating consumer protection laws, rules, and regulations, and enhance their credibility with account holders by reducing customer frustration and dissatisfaction.

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