

Cooperative Credit Union Association

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Creating Cooperative Power

OVERDRAFT PROTECTION BEST PRACTICES TO MINIMIZE RISK

OVERVIEW

Overdraft protection has been a member service debated by state and federal lawmakers, consumer advocates and in judicial settings. Credit unions have witnessed that courtesy pay programs are designed to help members timely meet their financial obligations, avoid embarrassment resulting from bounced checks and offer better value through education than found through other providers. Opponents claim this program is a means to earning income and/or exploiting lower income account holders.

There is lingering confusion and debate regarding the benefit and/or harm of overdraft protection programs, as well as a pool of attorneys across the country eager to find adversely impact “members” to file class-action lawsuits against credit unions and their members. These lawsuits are being compared to the rash of Americans with Disability Act lawsuits and demand letters that trend in cycles across the country. Often law firms actively seek plaintiffs who have been a “victim” of “multiple overdraft charges” and accused credit unions of “deceptive” and “unfair” practices based on the language in its overdraft contract.

Some law firms have established websites specifically aimed at credit union members who have been charged overdraft or insufficient funds fees on their accounts. Social media marketing campaigns have been used to source potential plaintiffs as well, using ads on facebook and other media. These ads encourage consumers to contact the firm to discuss a member’s situation with the goal of filing class action lawsuits.

Often the thrust of the member's claim is that the account agreement does not clearly state how the credit union will determine whether an account has sufficient funds. For example, some credit unions may use an available balance method, which accounts for pending transactions the credit union is obligated to pay and/or possible debit holds. Other credit unions may use an actual or ledger balance method, which accounts for settled but not pending transactions.

Credit unions that employ third party providers to design and implement their bounce protection program are strongly encouraged to conduct proper due diligence on the outsource provider selected. NCUA reminds credit unions that they are ultimately responsible in setting the parameters used to determine whose overdrafts will be paid.

From a risk assessment perspective, a credit union should consider:

- Does the credit union advance funds to pay share overdrafts without a contractual agreement?
- Does the credit union charge a fee for extensions of credit through bounce protection to cover share overdrafts?
- Does the credit union advertise the availability of bounce protection, courtesy pay, or another type of share overdraft payment program which does not rely on a written contract?

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ACTION STEPS

There are steps to take to help ensure that credit unions are positioned to defend against a demand letter or lawsuit from a class-action and/or an attorney representing a member threatening litigation or any perceived threat.

Regular reviews of the following are recommended:

1. Agreement language:

Review all account agreements for overdraft procedures. Pay close attention to how available and actual balances are explained and confirm that the language is clear to members.

Prominently distinguish balances from overdraft protection funds availability. When disclosing a single balance for an account by any means, credit unions should not include overdraft protection funds in that account balance. The disclosure should instead represent the member'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. A best practice is to consider using two or three scenarios explaining hypotheticals of actual and available balances and how fees are assessed and how transactions are applied, and in what order, to an account.

2. Policies and Procedures:

What are the overdraft procedures and policies used and when were they last reviewed? Are staff following procedures and policies and do they match how funds are applied and debited from accounts?

Does the board-approved policy set a cap on bounce protection advances? Does this policy establish a time limit for a member to deposit funds or to obtain an underwritten loan to cover overdrafts paid by bounce protection?

Does the policy limit the dollar amount of bounce protection overdrafts? Does the policy establish the fee to be charged members for the use of bounce protection? Does this policy require the notification of members when an advance is taken through bounce protection?

Promptly notify members of overdraft protection program usage each time used. Also, promptly notify members when overdraft protection has been accessed, for example, by sending a notice to members 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 members 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 members if the credit union terminates or suspends the member's access to the service, for example, if the member is no longer in good standing.

3. Returned Items:

In practice, how are returned items processed? Is the order changed based on an amount? Is this practice properly disclosed or could it be perceived as trying to increase fee income?

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4. Member Perspective:

What is printed on member account statements in terms of available versus actual account balance and does it cause confusion?

5. Communication:

How are holds disclosed on deposits and are they clear? Are examples provided?

Are all members automatically enrolled? Are members notified about their enrollment? Are members provided the opportunity to opt out?

6. Disclosures:

Has opt-in disclosure language recently been reviewed for compliance? Be sure to maintain copies of signed opt-ins.

Has the credit union clearly disclosed program fees? Does the credit union describe the bounce protection program as “free”? Is the total dollar amount imposed for bounce protection fees and the total dollar amount imposed for returned fees shown on the account statement?

7. Legal Review:

Consider having account agreements and policies reviewed by legal counsel.

8. Other Related Policies:

Has the Funds Availability Policy been reviewed and updated recently? Are practices and procedures in line with the policy?

9. Accounting:

Does the credit union report outstanding share overdrafts as unsecured credit on the quarterly call report? Is the unused portion of the disclosed bounce protection credit line reported as an “unused commitment” on the quarterly call report?

Are unpaid bounce protection overdraft amounts charged off against the Allowance for Loan and Lease Losses (ALLL)? Are unpaid bounce protection fee amounts charged off against income collected from the bounce protection program?

After bounce protection overdrafts are charged off, are member payments recorded as recoveries and posted to the ALLL? Does the credit union aggregate the unused limits and reserve for this “pool” based on past loss experience?

10. Additional Protections:

Even if the federal model for courtesy pay opt-in is followed, consider additional language for transparency and better protection.

Some credit unions include arbitration provisions in their account documents as a way to streamline the resolution of disputes with members. Arbitration is controversial in the member/owner setting but may be less expensive and contribute to a faster resolution than going to court.

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ADDITIONAL RESOURCES

SAMPLE OVERDRAFT POLICY WITH BEST PRACTICES

A sample overdraft policy which includes best practices available at PolicyPro may be found at: https://www.ccu.org/images/uploads/Model_Policy_-_Overdraft_Protection.pdf

CFPB

The CFPB's supplementary resources may be helpful while reviewing a program. In addition, it released a Study of Overdraft Programs in 2013 that may also provide insight.

<https://www.consumerfinance.gov/data-research/research-reports/the-cfpb-study-of-overdraft-programs/>

In 2017, the CFPB released a "Know Before You Overdraft" disclosure that is not required but that credit unions may consider for additional instructions to members.

<https://www.consumerfinance.gov/about-us/newsroom/cfpb-unveils-prototypes-know-before-you-owe-overdraft-disclosure-designed-make-costs-and-risks-easier-understand/>

[12 CFR 1030.11 - Additional disclosure requirements for overdraft services. \(govregs.com\)](#)

NCUA

Additionally, the NCUA possesses the authority to review overdraft policies and procedures for compliance under Regulation E as part of its supervisory priorities.

[NCUA LETTER TO CREDIT UNIONS - Overdraft Protection \(Bounce Protection\) Programs, Letter # 05-CU-03](#)

TRUTH-IN-SAVINGS/NCUA

Truth-in-Savings addresses the disclosure of credit union overdraft and bounce protection programs and is also found 12 C.F.R. [Section 707.11](#). The rule addresses disclosure requirements for overdrafts fees on each periodic statement: (1) the total dollar amount of all fees imposed for paying items when there are insufficient or unavailable funds in the account, and (2) the total dollar amount of all fees imposed for returning items unpaid. The rule requires these totals to be provided for both the statement period and year-to-date. The [commentary](#) to this section explains that these totals must include per-item fees, interest charges, daily or other periodic fees and any fees for maintaining an overdrafted account. Credit unions may itemize fees in addition to providing the totals but are not required to do so.

It also addresses advertising rules. If an advertisement promotes the payment of overdrafts, the rule requires that advertisement to also state that: (1) the fee for paying each overdraft, (2) which transactions a fee for paying overdrafts will be imposed on, (3) the time period the member has to repay the overdraft, and (4) when the credit union will not pay an overdraft. These disclosures must appear on the advertisement in a clear and conspicuous manner. The rule also provides a number of exceptions including member-initiated inquiries, television or radio advertisements, billboards, and ATM receipts.

NCUA 05-CU-21

[Overdraft Courtesy Pay Programs | National Credit Union Administration \(ncua.gov\)](#)

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REGULATION E

Regulation E prohibits credit unions from assessing a fee against a member's account for paying an ATM or one-time debit card transaction as part of an overdraft service unless the member has affirmatively consented to participate in the overdraft program. See, [12 C.F.R. 1005.17\(b\)\(1\)\(i\)-\(iii\)](#). The member must be provided with confirmation of the member's consent in writing, or if the member agrees, electronically, which includes a statement informing the member of the right to revoke such consent. 12 C.F.R. 1005.17(b)(1)(iv). The notice must be provided separately from all other information. Therefore, while the rule does not specifically require that a member opt-in to the overdraft program, it does prohibit the credit union from charging the member a fee for overdrawing an account.

An overdraft service is defined as a service where a credit union charges a fee on a member's account for paying a transaction when there are insufficient or unavailable funds in the account. [Section 1005.17\(a\)](#). Regulation E does not cover transfers of funds from the member's other accounts or overdraft services subject to Regulation Z.

The written notice must be substantially similar to [Model Form A-9](#). Section 1005.17(d) requires the notice to include: (1) a description of the overdraft service that includes the types of transaction that are covered by the service; (2) all fees associated with paying an overdraft including per-item fees, daily fees or other periodic fees and negative balance fees; (3) any maximum number of fees that will be imposed per day; (4) an explanation of the member's right to opt-in and (5) all other options for paying overdrafts that the credit union offers, such as a service that transfers funds from the member's other accounts.

[Member Notice Requirements for Overdraft Services | National Credit Union Administration \(nca.gov\)](#)

REGULATION B and REGULATION Z

Regulation B defines credit and consumer credit broadly to include credit union bounce protection and overdraft programs within its scope. It also contains a number of exceptions to provide adverse action notices. See, [12 C.F.R. 1002.3\(c\)\(1\) and \(2\)\(vi\)](#). Since most overdraft charges are not considered finance charges, depending on the program structure, an adverse action notice may not be required under Regulation B. See, [12 C.F.R. 1026.4\(c\)\(3\)](#). However, if a credit union denies an overdraft as part of an overdraft line of credit program, then there may be an obligation to provide an adverse action notice as fees related to overdraft lines of credit are typically considered finance charges.

UNIFORM COMMERCIAL CODE

Article 4 of the Uniform Commercial Code sets forth model laws that have been adopted to some extent in each state and generally permits credit unions to pay checks even though they may cause an overdraft. It also leaves questions regarding bounce protection programs to state contract and common law principles. See [U.C.C. 4-401](#). For example, specific bounce program practices may be subject to claims under state unfair or deceptive trade practices laws.