



# Compliance Corner

FEDERAL RESERVE BANK OF PHILADELPHIA

Prepared for institutions supervised by the Consumer Compliance & CRA Unit

## Interagency Guidance on Overdraft Protection Programs: Understanding the Legal Risks

by Eddie L. Valentine, Supervising Examiner

In recent years, depository institutions have begun offering overdraft protection programs to transaction account customers as an alternative to traditional ways of covering overdrafts. In response to concerns about the marketing, disclosure, and implementation of these programs the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency issued final joint guidance to assist insured depository institutions in the disclosure and administration of overdraft protection programs. Issued on February 23, 2005, the guidance addresses safety and soundness considerations, legal risks, and best practices observed in the industry.

In the first quarter 2005 issue of *SRC Insights*, Senior Examiner Joanne M. Branigan highlighted the risks associated with overdraft protection programs. In this issue, a more in-depth review of the legal risks associated with these programs is presented.

In offering overdraft protection programs, institutions must comply with all applicable federal and state laws. Financial institutions should have their overdraft protection programs reviewed by legal counsel prior to implementation to ensure overall compliance. Several federal consumer compliance laws are outlined in the guidance, including the *Federal Trade Commission Act Advertising Rules*, Regulation Z (*Truth in Lending Act*), Regulation B (*Equal Credit Opportunity Act*), Regulation DD (*Truth in Savings Act*) and Regulation E (*Electronic Fund Transfer Act*).

A brief discussion of the requirements of each law and how an overdraft protection program may create additional legal risk under that law is presented below.

### Federal Trade Commission Act / Advertising Rules

Section 5 of the *Federal Trade Commission Act* (FTC Act) prohibits unfair or deceptive acts or practices. An act or practice is considered deceptive

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if, in general, it is a representation, omission, or practice that is likely to mislead a consumer acting reasonably under the circumstances, and the representation, omission, or practice is material.

Overdraft protection programs may raise issues under the FTC Act depending upon how the programs are marketed and implemented. To avoid engaging in deceptive, inaccurate, misrepresentative, or unfair practices, institutions 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 that potentially may increase risk to the institution.

### **Truth in Lending Act**

The *Truth in Lending Act* (TILA) and Regulation Z require creditors to give cost disclosures for extensions of consumer credit. TILA and Regulation Z apply to creditors that regularly extend consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments.

Currently, fees for paying overdraft items are not considered finance charges under Regulation Z if the institution has not agreed in writing to pay overdrafts. Even where the institution agrees in writing to pay overdrafts as part of the deposit account agreement, fees assessed against a transaction account for overdraft protection services are fi-

nance charges only to the extent the fees exceed the charges imposed for paying or returning overdrafts on a similar transaction account that does not have overdraft protection.

Some financial institutions also offer overdraft repayment loans to consumers who are unable to repay their overdrafts and bring their accounts to a positive balance within a specified time period. In general, these closed-end loans will trigger Regulation Z disclosures if the loan is payable by written agreement in more than four installments. Regulation Z also is triggered when such closed-end loans are subject to a finance charge.

**Currently, fees for paying overdraft items are not considered finance charges under Regulation Z if the institution has not agreed in writing to pay overdrafts.**

### **Equal Credit Opportunity Act**

Under the *Equal Credit Opportunity Act* (ECOA) and Regulation B, creditors are prohibited from discriminating against an applicant on a prohibited basis in any aspect of a credit transaction. This prohibition applies to overdraft protection programs. Steering or targeting certain consumers on a prohibited basis toward overdraft protection programs while offering other consumers overdraft lines of credit or other more favorable credit products or overdraft services will raise concerns under the ECOA.

In addition to the general prohibition against discrimination, the ECOA and Regulation B contain specific rules concerning procedures and notices for credit denials and other

adverse action. Regulation B generally requires a creditor that takes adverse action to send a notice to the consumer disclosing, among other things, the reasons for the adverse action.

Some actions taken by creditors under overdraft protection programs might constitute adverse action but would not require notice to the consumer if the credit was deemed to be incidental credit as defined in Regulation B. Incidental credit includes consumer credit that is not subject to a finance charge, is not payable by agreement in more than four installments, and is not made pursuant to the terms of a credit card account.

Overdraft protection programs that are not covered by TILA would generally qualify as incidental credit under Regulation B.

### **Truth in Savings Act**

Under the *Truth in Savings Act* (TISA) and Regulation DD, deposit account disclosures must include the amount of any fee that may be imposed in connection with the account and the conditions under which the fee may be imposed. In addition, institutions must give advance notice to affected consumers of any change in a term that was required to be disclosed if the change may reduce the annual percentage yield or adversely affect the consumer.

When overdraft protection services are added to an existing deposit ac-

count, advance notice to the account holder may be required if the fee for the service exceeds the fee for accounts that do not have the service. In addition, TISA prohibits institutions from making any advertisement, announcement, or solicitation relating to a deposit account that is inaccurate or misleading or that misrepresents the institution's deposit contracts.

### Electronic Fund Transfer Act

*The Electronic Fund Transfer Act* (EFTA) and Regulation E require an institution to provide consumers with account-opening disclosures and to send a periodic statement for each monthly cycle in which an electronic fund transfer (EFT) has occurred and at least quarterly if no transfer has occurred. The EFTA and Regulation E would apply if, under an overdraft protection program, a consumer could

overdraw an account by means of an ATM withdrawal or POS debit card transaction, because both transactions are EFTs subject to EFTA and Regulation E. Periodic statements must be readily understandable and accurate regarding debits made, current balances, and fees charged. Terminal receipts also must be readily understandable and accurate regarding the amount of the transfer.

Readily understandable and accurate statements and receipts will help reduce the number of alleged errors that the institution must investigate under Regulation E, which can be time consuming and costly to institutions.

### Final Thoughts

Consumer compliance and safety and soundness examiners are utilizing this guidance in their evaluations

of overdraft protection programs. Therefore, institutions should review the guidance carefully to ensure that existing programs address the regulators' concerns. For a full text of the guidance, see SR Letter 05-3, *Interagency Guidance on Overdraft Protection Programs*, on the Federal Reserve Board's web site at <[www.federalreserve.gov/boarddocs/SR-LETTERS/2005/sr0503.htm](http://www.federalreserve.gov/boarddocs/SR-LETTERS/2005/sr0503.htm)>.

If you have any questions about this article, please contact either Supervising Examiner Eddie L. Valentine ([eddie.valentine@phil.frb.org](mailto:eddie.valentine@phil.frb.org)) or Supervising Examiner John D. Fields ([john.d.fields@phil.frb.org](mailto:john.d.fields@phil.frb.org)) through the Regulations Assistance Line at (215) 574-6568. ■

## Answers to Frequently Asked Questions About New HMDA Data

On March 31, 2005, the federal bank, credit union, and thrift supervisory agencies, along with the Department of Housing and Urban Development (HUD), released answers to frequently asked questions (FAQs) that address the new home loan price data that will be disclosed this year for the first time under the *Home Mortgage Disclosure Act* (HMDA). The FAQs will aid users with their evaluation and interpretation of the data.

The FAQs are part of the larger effort by the Federal Reserve Board, the Federal

Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and HUD to promote the informed use of the 2004 data.

A full understanding of the data, including its limitations, will help ensure that the data are used effectively to advance the goals of HMDA. The agencies plan to engage in educational outreach to state and local agencies, trade associations, and consumer- and community-based organizations.

In September, the Federal Financial Institutions Examination Council will release the annual summary statistical reports for each lender and an aggregate report for each Metropolitan Statistical Area. Concurrently, staff of the Federal Reserve Board will publish an article analyzing the 2004 data in the *Federal Reserve Bulletin*.

The FAQs are available on the Federal Reserve Board's website at <[www.federalreserve.gov/boarddocs/press/bcreg/2005/20050331/default.htm](http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050331/default.htm)>.

# New and Improved Federal Reserve Financial Education Web Site

The Federal Reserve System launched its redesigned financial education web site on April 18, 2005. This new and improved web site combines four Federal Reserve sites under one primary Federal Reserve Education web site and provides easier access to a variety of information in the areas of economics, banking, and financial services.

The primary purpose in redesigning the web site was to increase the use of Federal Reserve educational materials and to promote financial education in the classroom. The layout of the

web site focuses on the following four sections:

- **Federal Reserve Education** provides instructional materials to help improve teachers' and students' understanding of the Federal Reserve System, economics, and personal finances using a variety of sources and tools.
- **Fed 101** is an interactive tool designed to give an overview of the history and organization of the Federal Reserve System, monetary policy and federal regulations, and services provided to depository institutions.

- **Personal Financial Education** provides information on a variety of personal finance topics and is designed to aid consumers in making informed financial decisions.
- **Teacher Resources** is a search tool allowing teachers to locate Federal Reserve System educational materials on a variety of financial education topics. All of the materials meet national educational standards.

The web site can be accessed at [www.FederalReserveEducation.org](http://www.FederalReserveEducation.org). ■



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*Compliance Corner* is published quarterly and is distributed via *SRC Insights* to institutions supervised by the Federal Reserve Bank of Philadelphia. *SRC Insights* is available on the Federal Reserve Bank's web site at [www.philadelphiafed.org](http://www.philadelphiafed.org). Suggestions, comments, and requests for back issues are welcome in writing, by telephone (215-574-3760), or by e-mail ([cynthia.course@phil.frb.org](mailto:cynthia.course@phil.frb.org)). Please address all correspondence to: Cynthia L. Course, Federal Reserve Bank of Philadelphia, SRC - 7th Floor, Ten Independence Mall, Philadelphia, PA 19106-1574.

## Consumer Affairs Letters Are Now Available on the Federal Reserve Board's Web Site!

Earlier this year the Division of Consumer and Community Affairs of the Federal Reserve Board made Consumer Affairs Letters available to the public. Commonly known as CA Letters, Consumer Affairs letters address significant policy and procedural matters related to the Federal Reserve System's consumer com-

pliance supervisory responsibilities. The letters are sent to banking supervision staff at the Board and the Reserve Banks and, in some instances, to supervised banking organizations.

The letters are sequentially numbered by year. Currently, letters dating back to 2003 are located on the Federal Reserve Board's website at [www.federalreserve.gov/boarddocs/caletters/](http://www.federalreserve.gov/boarddocs/caletters/). ■