Regulatory Practice Letter

ADVISORY

RPL Number 09-03

Disclosure of Overdraft Fees – Final Rule Opt-Out Notice for Overdraft Fees for ATM and Debit Transactions – Proposed Rule

Subject:
Final Rule to Amend Regulation DD for Disclosures Related to Overdraft Fees;
Proposed Rule to Amend Regulation E to Provide an Opt-out Notice for Overdrafts Related to ATM and Debit Card Transactions

As Issued By:
Federal Reserve Board;

Date:
January 22, 2009

Executive Summary

On December 18, 2008, the Federal Reserve Board ("Fed") approved a final rule amending its Regulation DD, which implements the *Truth-in-Savings Act* ("TISA"), and the related official staff commentary to require all depository institutions to disclose aggregate overdraft fees on consumers' periodic statements, and to require account balances disclosed to consumers through an automated system to exclude any amount that may be available through an overdraft service or transfer from another account to cover insufficient or unavailable funds in the consumer's account. The final rule becomes effective January 1, 2010.

The Fed also approved a proposed rule to amend its Regulation E, which implements the *Electronic Funds Transfer Act*, and the related official staff commentary to limit the ability of a financial institution from assessing an overdraft fee related to automated teller machine ("ATM") withdrawals or one-time debit card transactions that overdraw a consumer's account unless the consumer is given an opportunity to either opt-out of, or opt-in to, the overdraft fees. These provisions were previously proposed in similar form under Regulation DD. Comments are due to the Fed within 60 days following publication in the *Federal Register*.

Background

In May 2008, the Fed published jointly with the Office of Thrift Supervision and the National Credit Union Administration proposed rules to prohibit institutions from engaging in certain acts or practices ("UDAP Proposal") in connection with consumer credit card accounts and overdraft services for deposit accounts (refer to RPL 08-07). Concurrently, the Fed released proposed rules to amend its Regulation DD to provide additional disclosures about account terms and costs associated with overdrafts, as well as content and timing requirements for a notice to consumers about any right to opt-out of an overdraft service (refer to RPL 08-09). Based on comments received on these proposed rules and consumer testing

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conducted on the proposed notice requirement, the Fed has finalized its UDAP Proposal without the overdraft services provisions (refer to RPL 09-01) and finalized its Regulation DD proposal without the opt-out notice requirement provisions (as discussed herein). The Fed has proposed to address the opt-out provisions, which include the opt-out notice requirement and fees for debit holds, through its Regulation E.

Description

Regulation DD – Final Rule

The final rule to amend Regulation DD requires all depository institutions to make the following disclosures with regard to overdraft fees:

- Each periodic statement must separately disclose the total amount of 1) the fees or charges imposed on an account for paying checks or other items when there are insufficient or unavailable funds and the account becomes overdrawn, and 2) the fees or charges imposed for returning items unpaid. The disclosures must include totals for the statement period and for the calendar year-to-date in a format substantially similar to the sample form in Appendix B to the rule.

  The disclosure requirement is applicable independently of whether an institution promotes its overdraft services. However, the disclosure is not applicable to fees associated with transferring funds from another account of the consumer to avoid an overdraft, or fees charged under a service subject to the Fed's Regulation Z (such as a line of credit).

- Account balance information disclosed to a consumer through an automated system may not include additional amounts that the institution may provide to cover an item when there are insufficient or unavailable funds, whether under a service provided in its discretion, a service to transfer funds from another account, or pursuant to a service subject to the Fed's Regulation Z (line of credit). An institution may make an additional disclosure of the account balance supplemented by funds available to cover overdrafts as long as the institution prominently states that such balances include these amounts.

  By way of example, if an institution adds a $500 cushion to a consumer's account balance when determining whether to pay an overdrawn item, the additional $500 could not be included in the balance provided to the consumer through an automated system. If the institution made an additional disclosure of the account balance supplemented by the $500 to cover overdrafts, it would be required to prominently state that the balance included this $500 to cover overdrafts.

Regulation E – Proposed Rule

A consumer's right to opt-out of, or opt-in to, overdraft services, which was originally included in the UDAP Proposal, and the content and timing requirements for such notices, which were originally included in the proposed Regulation DD provisions, have been re-proposed by the Fed under its authority provided by the *Electronic Funds Transfer Act*, which is implemented through Regulation E.

For purposes of Regulation E, "Overdraft services" would be defined to include services under which an institution charges a fee for paying a transaction (including a check or other item) that overdraws an account, where the payment is made pursuant to a promoted program or service or under an undisclosed policy or practice. It does not include payments made pursuant to a line of credit subject to Regulation Z or through a transfer of funds from another of the consumer's accounts at the institution.

Under Regulation E, the Fed has proposed to prohibit depository institutions from assessing an overdraft fee on a consumer's deposit account unless the institution provides the consumer with notice and reasonable opportunity to opt-out of, or opt-in to, the institution's overdraft service and the consumer does not do so. The proposal would apply only to overdrafts related to debit card transactions, which are defined as ATM withdrawals and one-time debit card transactions (whether at a point-of-sale terminal, online or by telephone). In contrast, the earlier UDAP Proposal would have applied to all transactions that overdraw an account including payments by check, ATM withdrawals, debit card purchases, or recurring payments.

Alternative #1 – Opt-Out Notice

The Opt-Out alternative would require a consumer to choose not to participate in an institution's overdraft services to pay overdrafts related to ATM and debit card transactions. As proposed, features of this alternative include:

- Only accounts opened on or after the effective date of the rule would be subject to the requirement that an opt-out notice be provided to a consumer before an overdraft fee is assessed.
- An opt-out notice would be required for consumers who have chosen not to opt-out or for whom an opt-out has not been exercised after assessing an overdraft fee. This requirement would apply to all accounts, including those existing on the effective date.
- A safe harbor of 30 days would be considered "reasonable opportunity" for consumers to opt-out of the overdraft service.
- Methods for conveying a consumer's choice to "opt-out" could include via mail, through a toll-free telephone number, online, or as a required step to opening an account.
- Institutions that require a consumer to opt-in to an overdraft service for ATM and debit card transactions would not be required to provide opt-out notices.

Alternative #2 – Opt-In Notice
The Opt-In alternative would require a consumer to affirmatively choose to participate in an institution's overdraft service to pay overdrafts related to ATM and debit card transactions. As proposed, some features of this alternative provide:

- For accounts opened and for which an overdraft service is provided prior to the effective date of the rule, an opt-in notice would be required to be provided to the consumer either 1) on or with the first periodic statement sent after the effective date of the rule, or 2) following the first assessment of an overdraft fee on or after the effective date of the rule. If a consumer does not provide an affirmative response to the opt-in notice within 60 days, the institution would be required to stop assessing fees for overdrafts related to ATM or debit card transactions and reject the ATM or debit card transaction, subject to certain exceptions.
- For accounts opened after the effective date of the rule, a notice would be required to be provided to a consumer prior to the assessment of any overdraft fee associated with an ATM or debit card transaction overdraft.

Some exceptions to the notice requirements and assessment of fees apply to both alternatives.

In either case, a consumer's right to opt-out of, or opt-in to, an institution's overdraft service with respect to ATM and debit card transactions may not be conditioned on the consumer opting-out of, or opting-in to (as appropriate), the payment of overdrafts with respect to checks and other types of transactions. In addition, an institution may not decline to pay overdrafts on checks or other types of transactions if a consumer opts-out of, or opts-in to, its overdraft service for ATM and debit card transactions.

Model notice forms are provided for both the Opt-Out and Opt-In alternatives as an appendix to the rule and, under either option, institutions must provide notices to consumers in a format substantially similar to these model forms.

Debit Holds
When a consumer uses a debit card to make a purchase, a block, or hold, may be placed on the account to ensure that the consumer has sufficient funds in the account when the transaction is presented for settlement. This type of block or hold is referred to as a "debit hold." In some cases, such as with gasoline or hotel transactions, the actual purchase amount is not known at the time the transaction is authorized and an institution may place a debit hold on the account for an amount that exceeds the actual transaction amount.

The proposed rule incorporates the debit hold provision originally proposed in the UDAP Proposal. Thus, as proposed, institutions would generally be prohibited from assessing an overdraft fee pursuant to its overdraft service if the overdraft would not have occurred but for a debit hold placed on the account if the amount of the hold exceeds the amount of the transaction. The prohibition would apply only in circumstances where the actual amount of the transaction could be determined within a short period of time after authorization, such as with gasoline or restaurant transaction charges.

A safe harbor is proposed for institutions that have procedures and practices in place that are designed to release the hold within a reasonable period of time, which would be deemed to be within two hours of authorizing the transaction.

KPMG Commentary

With the Fed issuing the final rules to UDAP, Regulation Z and Regulation DD concurrently, financial institutions will need to consider the inter-connectivity of changes to their prospective institution.

With the final changes to Regulation DD, financial services institutions will need to begin reviewing systems and processes to assess what changes will need to occur to ensure compliance by the effective date. Institutions will need to begin to consider changes to systems and processes to consumer fee disclosures, periodic statements and available funds calculations.

The Fed indicates that, based on comments received on its UDAP Proposal and subsequent consumer testing, consumers would benefit most from the right to opt-out of, or opt-in to, overdraft services related to ATM and debit card transactions rather than fees associated with checks and other transactions, as these fees tend to be high in relation to the amount of the overdraft and do not involve other merchant-driven fees.

With the proposed changes to Regulation E, institutions will not only have to consider changes to systems and processes if the proposal becomes final, but will also need to look at changes to fee income structure. Financial institutions will need to estimate fee income impact and determine if other sources of fee income will be necessary. The proposed rule is very detailed and institutions are encouraged to review it and provide comment.

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