



Credit Union National Association

CUNA Issue Summary

OVERDRAFT PROTECTION

ISSUE: Credit unions and other financial institutions have long been involved in providing some form of overdraft or bounced check protection for their members and customers. For credit unions, this is fully consistent with their philosophy and mission to serve members' financial needs and to help them resolve short-term financial problems. Initially, many credit unions simply provided members with courtesy transfers from their savings accounts to cover any checks that exceeded the balance in their savings accounts. However, as members' savings declined and the complexity of electronic banking increased both the number and dollar amounts of overdrafts, it became imperative to find new and innovative approaches to better address this member need.

Today, many credit unions continue to offer their members overdraft protection by providing a set number of automatic transfers from regular savings or money market accounts. Others also provide special lines of credit attached to checking accounts to protect against overdrafts or to allow for special purchases. Still others have followed the example of the banks in structuring formal courtesy pay or overdraft privilege programs. While the terms and features of these overdraft privilege programs may vary, most are consistent in offering to pay, rather than return, non-sufficient funds transactions on checking accounts in exchange for fees that are similar to those typically charged for returned items. All these programs are intended to spare members the embarrassment of returned checks as well as avoid additional fees charged by merchants.

CUNA POSITION: As more credit unions began to initiate overdraft protection programs, CUNA sought to encourage its members to adopt "best practices" standards to distinguish credit union overdraft services from many bank programs that were being marketed to boost fee income without regard for the best interests of consumers. CUNA has adopted policy positions supporting the ability of credit unions to offer overdraft privilege programs, but urging credit unions to avoid practices that are inconsistent with the philosophy and principles that are unique to the credit union system. In particular, CUNA called on credit unions to refrain from:

- Deceptive advertising that leads consumers to expect all overdrafts to be paid when other documents indicate payment of overdrafts is discretionary;
- Promoting overdraft protection in a manner that encourages consumers to frequently or regularly overdraw their account;
- Enticing consumers to overdraw their accounts by including the amount of overdraft coverage as part of "available funds" in ATM messages, online statements and telephone balance statements; and
- Failing to inform frequent users of overdraft protection services of available alternatives that could be more appropriate and less expensive.

STATUS/OUTLOOK: On February 8, 2007, Representative Carolyn Maloney (D-NY), the Chairwoman of the Subcommittee on Financial Institutions and Consumer Credit, introduced H.R. 946, the *Consumer Overdraft Protection Fair Practices Act*. The bill seeks to eliminate abusive overdraft protection practices. On July 11, 2007, the Subcommittee on Financial Institutions and Consumer Credit held a [hearing](#) titled, “Overdraft Protection: Fair Practices for Consumers,” during which Mary Cunningham, CEO of USA Federal Credit Union, testified on behalf of CUNA. While Ms. Cunningham’s testimony was generally supportive of efforts to eliminate abusive practices in overdraft protection programs, CUNA staff expressed concerns to subcommittee staff regarding the operational burdens the legislation would impose as well as the statutory restrictions that would likely prevent credit unions from continuing to offer these programs, if the legislation were to become law. Subcommittee staff agreed to discuss these concerns prior to the legislation moving forward.

On September 20, 2007, CUNA was advised that the House Financial Services Committee intended to consider H.R. 946 on September 25th. CUNA staff again expressed credit unions’ concern regarding the legislation, and offered several alternatives to the bill as introduced, including a substitute amendment that would have classified overdraft protection products under the *Truth in Savings Act* (TISA), as well as language that would have exempted the application of the usury ceiling from the calculation of the APR for overdraft products, and language to extend the effective date of the legislation. Committee staff agreed to accept CUNA’s suggested language to address the usury ceiling issue and also agreed to a compromise extension of the effective date. However, when it became apparent that negotiations with the committee staff were not going to be successful, CUNA sent a [letter](#) to the members of the committee outlining the credit union opposition to the legislation. As a result of CUNA’s opposition to the legislation, combined with the opposition of the various banking trades, several members of the Committee indicated that they would oppose the legislation if significant changes were not made. The legislation was subsequently removed from committee consideration. As a result of the Maloney legislation and the hearing, federal regulatory agencies have proposed rules that would accomplish much of what her legislation intended.

IMPACT ON CREDIT UNIONS: CUNA believes that overdraft protection programs are not a lending product subject to TILA. In addition, the statutory credit union usury ceiling would make such programs unworkable for credit unions. Also, without an opt-in requirement for those already being served, a 90 day effective date makes the legislation unworkable.

H.R. 946 would make several changes to the way that overdraft protection programs are treated under the law. Most troublesome, the bill would classify overdraft protection products under the *Truth in Lending Act* (TILA), and require financial institutions to include the service fee associated with the overdraft protection program as a finance charge, and include it in an APR calculation. This presents credit unions with two issues: (1) the calculation of an APR on a transaction like this would, in most cases, cause the interest rate on the “loan” to exceed the usury ceiling in the Federal Credit Union Act; and (2) credit unions have historically believed that these products are not lending products.

Secondly, H.R. 946 would require that consumers opt-in to overdraft programs by signing a written disclosure, and require financial institutions to obtain written disclosures from members already being served by overdraft protection program. And, it would give financial institutions 90 days within which to become compliant with legislation. The quick effective date of the legislation, combined with the burden of having to go out and get members to sign-up for this service, would present credit unions (and banks) with considerable operational difficulties.

The legislation, as introduced, also has additional provisions including a requirement that financial institutions disclose to the consumer if an ATM or point-of-sale (POS) transaction will cause an overdraft in the account; a prohibition against manipulating debits and credits to an account in order to generate overdrafts; and a prohibition on advertising a checking account as a "free" account if overdraft protection is offered as a service of the account for a fee.

UPDATE: On May 2, 2008, a joint proposal from the National Credit Union Administration (NCUA), the Federal Reserve Board, and the Office of Thrift Supervision was released regarding overdraft protection plans and practices relating to credit cards. In addition, the proposal included possible amendments to Regulation Z (Truth in Lending) and Regulation DD (Truth in Savings) to complement the unfair acts and deceptive practices proposals. For credit cards, the proposal addressed time periods for making payments, payment allocations, interest rate increases on outstanding balances, fees resulting from credit holds, methods for computing balances subject to interest charges, excessive security deposits and fees charged when credit is issued, and advertisement that include multiple interest rates and multiple credit limits. On overdraft protection plans, the draft requires consumers to be given an opportunity to "opt-out" of the plan, and addresses fees resulting from holds on debit card transactions. A comment period of 75 days was initiated (due August 4, 2008).

On May 19, 2008, additional proposed rules dealing with credit and overdraft programs were published in the Federal Register. The Federal Reserve Board initiated a comment period on an amendment to Regulation Z (Truth in Lending) seeking input on creditors' instructions for ensuring timely payments when a due date falls on a weekend or a holiday, their responsibilities in investigating a claim of unauthorized transactions or alleged billing errors, and advertisements for deferred interest plans. Comments are due July 18th. The other Fed proposed rule would amend Regulation DD (Truth in Savings) by addressing content and timing requirements for notices of the right to opt out of an overdraft services, disclosures of overdraft fees by all institutions (not just those which promote overdraft services) and balance disclosures. While not directly applied to credit unions, NCUA is required to adopt similarly substantial rules for credit unions. Comments on this proposal are also due July 18th. Finally, the Fed and the Federal Trade Commission have proposed that card issuers be required to notify a consumer if the terms and rates offered are less favorable than for other borrowers due to information in the consumer's credit report. Comments on this proposal are due August 18th.

In 2008, CUNA revised its official policies to address new realities in the financial services marketplace. CUNA supports the ability of credit unions to offer overdraft protection plans as a means to help their members resolve short-term financial problems. This is in contrast to others who may heavily market these programs in an often misleading manner.

While the terms of credit union overdraft protection programs may vary, they are structured to pay, rather than return, non-sufficient funds transactions in exchange for fees that are similar to those charged for returned items. This spares members the embarrassment of returned checks, as well as additional fees charged by merchants and other payees. Such programs, when used appropriately by members, serve as a valuable alternative to overdrawing share drafts and are fully consistent with the philosophy and principles unique to the credit union system. To that end, CUNA would support new law or regulation that:

- Prohibits the manipulation of debits and credits with the intent of generating overdraft fees.
- Provides clear and conspicuous disclosure of all costs associated with these programs to ensure that credit union members have the ability to compare the costs and features of overdraft protection programs among the various types of financial institutions that offer them.
- Recognizes, consistent with the current Federal Reserve Board position, that funds accessed through overdraft protection programs are not loans and do not require that fees be calculated and disclosed as an “annual percentage rate” under the Truth in Lending Act.
- Permits, but does not require, credit unions to obtain a written agreement from members to participate in an overdraft protection program, while recognizing the need to allow members to decline participation in the program if they so choose.
- Does not impose new burdensome requirements on credit unions with which compliance would be difficult to achieve. This would include, but is not limited to, requiring new disclosures on automated teller machine transactions.

CUNA’s Board of Directors also calls on every CUNA member credit union that offers overdraft protection services to adopt overdraft protection standards and ethical guidelines that will help emphasize credit unions’ concern for consumers and further distinguish credit unions as institutions that care more about people than money. When offering overdraft protection services, credit unions adopting these guidelines and ethical standards recognize that the following practices are **NOT** consistent with the credit union philosophy and principles and publicly affirm that they will not engage in any of these practices:

- **Deceptive Advertisement:** Advertising, representing, or implying that the member should expect that all overdrafts will be paid but then stating in other documents that the paying of overdrafts is discretionary, which is a standard feature of overdraft protection plans. Such advertising may lead members to rely on the service in expectation that all overdrafts will be paid, which would be detrimental if any overdrafts are not ultimately paid by the financial institution.
- **Enticing Members to Overdraw Accounts Repeatedly:** Advertising or promoting the overdraft protection plan in a manner that encourages the member to overdraw repeatedly his or her share draft account, as opposed to such a plan being used as an occasional convenience for the member. The frequent overdraw of accounts is a practice that financial education programs, such as those offered by credit unions, generally discourage.
- **Structuring Programs that Mislead Members:** Including a feature that records the amount of coverage being offered to cover overdrawn share drafts as part of the “available funds,” such as on ATM receipts, online statements and telephone balance statements.

- Failure to Inform Heavy Users of Overdraft Protection Programs of Alternatives: Overdraft protection programs may not be appropriate for members who heavily use and rely on overdraft protection programs as a means to pay a significant proportion of every day living expenses. For these members, credit unions may offer a number of other products and services that would be more appropriate. These may include transfers from a savings account to the share draft account, as well as other types of less expensive secured and unsecured loans that the credit union offers to all its members.
- Failure to Provide Financial Counseling Information: Credit unions recognize that they have a role in helping their members use overdraft protection services in a responsible manner. In addition to providing adequate disclosures regarding the features and fees associated with the programs, credit unions should also provide information regarding counseling services provided by the credit union or other reputable counseling services.

On July 18, 2008, CUNA wrote a [letter](#) supporting a Federal Reserve Board plan that would allow consumers to "opt out" of overdraft protection plans. However, CUNA strongly opposed forcing financial institutions to give notice of opt-out rights to consumers in any periodic statement period in which the service is used. The repeated opt-out notices would be too burdensome for credit unions, with very little benefit for consumers. CUNA also believes that the proposed opt-out notice requirements should not apply at all to credit unions or other financial institutions that currently use an "opt-in" approach in which consumers affirmatively choose to enroll in these plans. Under this approach, consumers have clearly expressed their intentions, and it is simply unnecessary to provide them with additional notices of their right to opt-out of a service in which they voluntarily elected to participate. The Fed's proposed rule to amend Regulation DD, the *Truth in Savings Act*, if adopted, would not apply directly to credit unions. However, the National Credit Union Administration is required to adopt substantially similar rules for federal credit unions. Also, the Fed, NCUA and Office of Thrift Supervision worked jointly on related proposed rules for unfair and deceptive practices. CUNA also will be submitting a comprehensive comment letter on this to the NCUA. Because this (Regulation DD) proposal is intended to complement and be consistent with the proposal recently published by NCUA, the Fed, and the OTS that addresses unfair and deceptive practices as they pertain to credit cards and overdraft protection plans, CUNA strongly believes that the effective date of these proposals should be the same. In addition, mandatory compliance should not be required until at least two years after these rules are finalized since they are intertwined with several comprehensive proposals that will amend the Regulation Z open-end credit rules. This is an issue addressed in a separate CUNA comment [letter](#) to the Fed.

CUNA's Regulatory Affairs Department [comments](#) on proposed regulations. CUNA lobbyists will continue to monitor overdraft protection legislation and support efforts to weed out questionable industry practices while also protecting credit unions and their members from any unintended consequences that would hamper the availability and affordability of overdraft protection programs.

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