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**MEMORANDUM**

February 18, 2005

To Our Clients and Friends

Re: Agency Guidance on Overdraft Protection Programs

The Office of Thrift Supervision, National Credit Union Administration, Comptroller of the Currency, Federal Reserve Board, and the Federal Deposit Insurance Corporation (the “Agencies”) have issued final guidance concerning overdraft protection programs offered by depository institutions.<sup>1</sup> “Bounced-check protection” programs are often offered as an alternative to overdraft lines of credit or linked deposit accounts. The guidance addresses marketing, implementation and disclosure aspects of overdraft protection programs.

**SAFETY AND SOUNDNESS CONSIDERATIONS**

The guidance indicates that when overdrafts are paid, credit is extended.<sup>2</sup> Accordingly, financial institutions should take into account the following safety and soundness considerations:

- Adopt written policies and procedures to address credit, operational, and other risks associated with overdraft programs
- Adopt account eligibility standards and dollar-limit decision criteria
- Monitor accounts on an ongoing basis
- Administer programs to ensure that credit risk is in line with expectations
- Charge off unpaid overdrafts within 60 days
- Follow GAAP and regulatory reporting instructions for reporting income and losses
- Conduct due diligence reviews of third-party vendors
- Apply appropriate risk-based capital treatment to overdrafts and unused commitments.<sup>3</sup>

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<sup>1</sup> The OTS’ guidance was issued separately from the guidance of the other Agencies.

<sup>2</sup> The OTS guidance, however, does not address whether overdrafts are credit because the OTS believes that some programs are provided to customers as a fee for service rather than an extension of credit.

<sup>3</sup> OTS guidance does not address the risk-based capital treatment of overdrafts.

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### LEGAL RISKS

The guidance also addresses legal risks associated with overdraft protection programs.<sup>4</sup> These include federal laws and regulations affecting overdraft protection programs, such as the Federal Trade Commission Act, the Truth in Lending Act, Regulation Z, the Equal Credit Opportunity Act, Regulation B, the Truth in Savings Act, the Electronic Fund Transfer Act and Regulation E.

### BEST PRACTICES

The guidelines also highlight best practices that the financial industry currently observes or recommends. These include:

- Avoid promoting poor account management
- Fairly represent overdraft protection programs and alternatives
- Train staff to explain program features and other choices
- Clearly explain the discretionary nature of the program,
- Distinguish overdraft protection services from free account features
- Clearly disclose program fees
- Clarify that fees count against the disclosed overdraft protection dollar limit
- Demonstrate when multiple fees will be charged
- Explain the impact of transaction clearing policies
- Illustrate the type of transactions covered

The OTS' guidance also indicated that thrift institutions should not manipulate transaction-clearing rules to inflate fees.

The Agencies also indicated that programs should:

- Provide election or opt out of the service
- Alert the customer before a transaction triggers any fees
- Prominently distinguish balances from overdraft protection funds availability
- Promptly notify consumers of overdraft protection program usage each time used
- Consider daily limits on the consumer's costs
- Monitor overdraft protection program usage
- Fairly report program usage

A copy of the Agencies' Guidance can be found on our web site at [http://www.schwartzandballen.com/whats\\_new.html](http://www.schwartzandballen.com/whats_new.html). If you have any questions, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.

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<sup>4</sup> The OTS' guidance does not address legal risks.