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## Federal Reserve Requires Banks to Implement New Overdraft Procedures and Related Disclosures

The Federal Reserve emphasized its newly donned role of the consumer protector on November 12, 2009 when it issued final revisions to Regulation E (the "Final Rule") that will require many banks to revise their existing procedures for paying and disclosing consumer overdrafts that result from automated teller machine ("ATM") and one-time debit card transactions. Banks are required to achieve full compliance with the Final Rule by July 1, 2010. For many banks, it is likely that full compliance will involve significant operational and processing changes, as well as the implementation of new procedures and new customer disclosures. These types of changes take time to implement, and so we recommend that banks act immediately to assess their overdraft protection services in light of the Final Rule, in order to determine what changes will be necessary to achieve timely compliance.

### **Overview of the Federal Reserve's Final Rule**

The Final Rule adopted by the Federal Reserve amends Regulation E, which implements the Electronic Funds Transfer Act. The effect of the Final Rule will be to limit banks' ability to assess an overdraft fee for paying ATM and one-time debit card transactions that overdraw a consumer's

account, unless the consumer affirmatively consents (or "opts in") to the payment of such overdraft.

The following is a short list of the most substantive provisions of the Final Rule. Each of the listed provisions is discussed in more detail in the "Section-by-Section Analysis" that is included later in this client alert.

- *Opt-In Right.* Before a bank may assess overdraft fees for any ATM or one-time debit card transaction, the consumer must affirmatively consent, or "opt in," to the bank's overdraft payment services. The consumer will have the ongoing right to revoke this consent.
- *Consumers Covered.* With very limited exceptions, all consumer account holders must be provided with the Final Rule's opt-in right, including for both new and existing accounts.
- *Prohibition on Conditioning the Opt-In Right.* A bank may not condition payment of overdrafts for checks and other transactions to a consumer's opting in to the bank's overdraft service for ATM and one-time debit card transactions.

→ *Requirement for Consistent Account Terms, Conditions and Features.* Banks must provide consumers who do not opt in with the same account terms, conditions and features (including price) as they provide to consumers who do opt in.

→ *Mandatory Compliance Date.* The date for mandatory compliance with the new Final Rule is July 1, 2010.

### Section by Section Analysis

#### *Regulation E versus Regulation Z.*

Consumer advocates have long argued that overdrafts should be treated as loans, subject to the full disclosure provisions of the Truth in Lending Act (“TILA”) and Regulation Z. Despite the continued pleas of the consumer advocates, the regulators have long maintained that overdrafts do not constitute loans that would require such disclosure. The basis of this position is that banks are not contractually required to pay overdrafts.

My colleague Peter Weinstock and I have examined the merits of the “loan versus overdraft” argument in great detail in our prior article titled “Overdraft Protection Programs: The Emerging Battleground for Bankers and Consumer Advocates,” which was published in the October 2004 volume of the *Banking Law Journal*. For the purposes of this client alert, however, it is sufficient to note that the Federal Reserve’s new rule does not represent any change in the regulatory position that overdrafts are not “loans” for the purposes of TILA and Regulation Z. Although the consumer advocates raised this argument again in connection with the Federal Reserve’s initial proposal of the Final Rule, the

Fed quickly dismissed the argument, stating that the addition of an overdraft service to an ATM or other access device does not constitute the addition of a credit feature under Regulation Z.

*Opt-In Requirement.* Despite its rejection of the consumer advocate’s Regulation Z argument, the Federal Reserve bent to the will of consumers when it included the affirmative consent, or opt-in, requirement in the Final Rule. Bank and industry associations, in response to the proposed version of the Final Rule, strongly urged the Fed to adopt an *opt-out* approach for overdraft services on ATM and one-time debit transactions, at least with respect to existing accounts. These groups raised loud objection to the proposed opt-in requirement, pointing to significant operational burdens and the potential confusion that will inevitably result from an opt-in requirement. Nonetheless, the Federal Reserve summarily rejected the concerns of its regulated constituency, and has chosen instead to follow “consumer preference.” In justification of its position (and in denying industry suggestions with respect to many other aspects of the Final Rule), the Fed simply points to the results of consumer testing, which show that consumers generally prefer for banks to reject overdrafts on ATM and debit transactions, while they generally prefer for banks to pay overdrafts on checks. In deference to this preference, the Final Rule now requires banks to affirmatively obtain the consent of consumers before charging overdraft fees in connection with ATM or one-time debit card transactions. No such consent will be required for the payment of overdrafts resulting from a bounced check.

Section 205.17 of the Final Rule sets forth the Final Rule’s general prohibition against a bank’s assessment of any fee or charge on a consumer’s account for paying an ATM or one-time debit card transaction pursuant to the bank’s overdraft service, unless the consumer is provided with a notice explaining the service and a reasonable opportunity to affirmatively consent, and the consumer does affirmatively consent. If the consumer opts in, then the bank will be required to provide the consumer with a confirmation of the consent. Notably, the opt-in right applies only to the assessment of fees and not to the payment of the overdraft itself. Consequently, a bank could still decide to pay and collect the amount of any consumer overdraft without first obtaining the consumer’s affirmative consent. It just would not be able to charge a fee for this service.

#### *Transactions Subject to the Final Rule.*

The above-described opt-in requirement is applicable to a bank’s “overdraft services” provided in connection with all ATM transactions and all one-time debit card transactions. The scope of covered ATM transactions includes more than simply cash withdraws. It also reaches transactions used for inter-account transfers, bill payments and even postage stamp purchases. By contrast, the Final Rule does not reach all debit card transactions. The Federal Reserve intentionally included the “one-time” qualifier in order to clarify that providing overdraft services for recurring debit transactions will not trigger the Final Rule’s opt-in right.

For the purposes of the Final Rule, an “overdraft service” is defined as a service under which a financial institution assesses a fee or charge on a consumer’s account held by

the institution paying a transaction when the consumer has insufficient or unavailable funds in the account. The broad definition is intended to cover circumstances when a bank assesses an overdraft fee in connection with any automated program, whether promoted or not, or as a nonautomated, ad-hoc service to its customers. The term does not include payment of overdrafts pursuant to transfers from a credit card account, a home equity line of credit or an overdraft line of credit. The definition also excludes overdrafts covered from another account of the consumer that is held at the bank. Accordingly, payment of overdrafts pursuant to these excluded types of services are outside the scope of the Final Rule and do not require the consumer's additional affirmative consent.

**Notice Requirements.** The Final Rule requires banks to provide consumers with a notice explaining its overdraft service for ATM and one-time debit card transactions. This notice must be provided in writing (or if the customer agrees, electronically), and it must be segregated from all other account information, including other account disclosures. In addition, the method for providing consent, such as a signature line or check box, must be separate from other types of consents.

The Final Rule provides specific instructions regarding how notice and consent are to be provided to, and obtained from, consumers. The Final Rule's notice requirement does not provide banks with much flexibility, in that it states that the required consumer opt-in notice may not contain any information that is not specified or otherwise permitted by the Final Rule. Moreover, the Final Rule includes a model form of notice ("Form A-9"), and requires that all

opt-in notices under the Final Rule be in a form substantially similar to Form A-9. A copy of Form A-9 may be obtained from the Federal Reserve's website at <http://www.federalreserve.gov>. Other types of information that the Final Rule permits to be included with the overdraft notice include language describing transactions that are not subject to the opt-in right or that are subject to a separate opt-out right. For example, a bank may modify Form A-9 to clarify that the consumer has the right to opt out of payment of overdraft services for check transactions, ACH transactions or automatic bill payments, and, if so, may disclose the amount of a returned item fee and that additional merchant fees may apply.

The Final Rule also provides specific guidance on what will, and what will not, be considered appropriate methods for obtaining consumer consent to covered overdraft services. The following are four ways that banks can provide consumers a "reasonable opportunity" to opt in:

- A written consent form may be provided to consumers, which they can complete and mail back to the bank.
- The bank may (but is not required to) provide a readily available telephone number that consumers can use to opt in. (Note that this does not obviate the need for the bank to provide a specific form of notice as described above.)
- The bank may provide a form that can be accessed and processed at its website, where the consumer may click on a check box to provide consent and confirm that choice by clicking on a button affirming that consent.

- The bank may provide a form that the consumer may complete in person at a branch or other bank office in order to provide his or her affirmative consent.

The Final Rule emphasizes that a bank *will not* be considered to have appropriately obtained a consumer's consent to overdraft services when the bank has included preprinted language about such services in an account disclosure provided with a signature card or contract that the consumer must sign to open the account. Nor does the bank obtain a consumer's affirmative consent by providing a signature card that contains a preselected check box indicating that the consumer is requesting the services. Significantly, this does not mean that a consumer's consent may not be obtained at the time of account opening. It simply means that the notice and consent may not be included with other disclosures and that the consent form used must *solely* indicate the consumer's choice whether to opt in to overdraft services.

After the bank has obtained a consumer's consent, using one of the appropriate methods described above, the Final Rule then requires the bank to provide the consumer with a written confirmation documenting the consumer's choice. The confirmation requirement may be satisfied by providing the consumer with a copy of its completed opt-in form, or by sending a letter or other document to the consumer acknowledging that the consumer has elected to opt in to the overdraft services. The written confirmation must include a statement informing the consumer of the right to revoke consent. Therefore, if a bank complies with this requirement by providing the customer with a

copy of its opt-in notice, that notice should include a statement about the customer's right to revoke consent. The Final Rule's confirmation requirement may also be satisfied electronically, if the customer agrees.

*Prohibition on Conditioning Payment of Other Types of Overdrafts on Opting In.* The Final Rule contains an express prohibition on conditioning the payment of any overdrafts for checks, ACH transactions or other types of transactions on the consumer's affirmatively consenting to the bank's payment of overdrafts for ATM withdrawals and one-time debit transactions. The final rule also prohibits banks from declining to pay checks, ACH transactions or other types of transactions because the consumer has not also affirmatively consented to the bank's overdraft service for ATM and one-time debit card transactions. The Final Rule refers to these practices collectively as "conditioning" the consumer's opt-in right.

Importantly, the Final Rule's prohibition on "conditioning" does not mean that banks are required to pay all consumer overdrafts, even if those consumers have not opted in to overdraft services for ATM and one-time debit card transactions. The Final Rule clarifies that a bank is simply required to apply the same criteria for deciding when to pay overdrafts for checks, ACH transactions and other types of transactions, whether or not the consumer has affirmatively consented to the bank's overdraft service with respect to ATM and one-time debit card overdrafts. As an example, the Final Rule states that if a bank's internal criteria would lead it to pay a check overdraft of a consumer that has affirmatively consented to its ATM and one-time debit card overdraft services, it must also apply that some criteria in

a consistent manner when determining whether to pay a check overdraft if the consumer has not opted in.

*Similar Account Terms Requirement.* The Final Rule requires banks to provide consumers who do not opt in to its overdraft services for ATM and one-time debit card transactions an account with the same terms, conditions and features that it provides to consumers who affirmatively consent, except for features that limit the bank's payment of such overdrafts. The Final Rule includes a "nonexclusive" list of example terms, conditions and features that cannot be varied. Those examples include fees and interest rates, minimum balance requirements, account features such as online bill payment services, and the type of ATM or debit card provided to the account holder.

The Federal Reserve emphasized that the similar-terms requirement is not intended to interfere with state banking laws or other limited-feature accounts that are typically marketed to consumers who have historically had difficulty entering or remaining in the banking system. The Final Rule explains that it does not prohibit banks from offering deposit accounts with limited features, so long as the consumer is not required to open such an account because the consumer did not opt in. As a specific example, the Final Rule states that banks are not prohibited from offering a checking account designed for consumers who are not eligible to receive a full-service account based on their credit or other checking account history, which may include features limiting the payment of overdrafts. Nonetheless, banks may not steer consumers who do not opt in to an account with fewer features than the

account for which the customer initially applies and is otherwise eligible.

*Limited Exception to the Final Rule's Notice and Opt-In Requirements.* Although the above-described notice and opt-in requirements will generally be applicable to all consumer ATM and one-time debit transactions, the Final Rule does carve out one limited exception. Specifically, there is an exception to the Final Rule's general notice and opt-in requirements if the bank has a policy and practice of declining to authorize and pay any ATM or one-time debit card transactions with respect to a type of deposit account offered by the institution when the institution has a reasonable belief at the time of the authorization request that the consumer does not have sufficient funds to cover the transaction. This exception is available even if the bank's other accounts are subject to the Final Rule's notice and opt-in requirements. For example, if a bank offered three types of checking accounts and the bank has a policy of not paying ATM or one-time debit card overdrafts for one of those types of accounts, that one type of account would not be subject to the Final Rule's notice and opt-in requirements. The other two types of accounts would remain subject to the Final Rule.

*Timing for Compliance.* Mandatory compliance with the Final Rule is required by July 1, 2010. For accounts opened prior to this date, banks must not assess any fees or charges on a consumer's account after August 15, 2010 for paying an ATM or one-time debit card transaction pursuant to an overdraft service, unless an affirmative consent has been obtained. For accounts opened after July 1, 2010, the bank must comply with the Final Rule immediately upon account

opening and obtain the consumer's affirmative consent before assessing any overdraft fee or charge in connection with an ATM or one-time debit card transaction. For both new and existing account holders, a bank may not retroactively apply affirmative consents to overdrafts that are paid before the consent is obtained.

### Implications of the Final Rule

The requirements of the Final Rule have significant procedural and operational implications for banks. Achieving full compliance with the Final Rule will also likely necessitate material technological enhancements to most banks' payment systems.

Prior to July 1, 2010, banks will need to update their procedures and forms for providing consumer overdraft disclosures. Existing overdraft disclosures, policies and procedures should be reviewed and revised by counsel in order to properly segregate ATM and one-time debit card transactions from the types of overdraft services that banks typically include in their general automated or program services. New, separate overdraft disclosures and consent forms (both for paper and online delivery channels) that meet the requirements of the Final Rule will need to be developed for ATM and

one-time debit card transactions. In addition, new procedures will need to be prepared and implemented that provide for delivery of the new disclosures, through a method that satisfies the Final Rule's requirements, both at the time of account opening and on all existing accounts that are subject to the Final Rule.

Before the date for full compliance, banks will also need to assess, and if necessary update, their payment technology systems so that those systems will have the capability to satisfy the Final Rule's requirements. To effectively comply with the Final Rule, a bank's payment technology systems will need to be able to differentiate between different types of transactions that may create overdrafts, such as between checks and ATM withdrawals. They will also need to be able to differentiate between one-time and recurring debits. In addition, banks may need to update Internet and telephone banking systems to provide additional methods for consumers to opt in to ATM and one-time debit card overdraft services.

### What to Do Now

As indicated by the implications discussed above, the Final Rule will require banks to undertake a number

of procedural and technological initiatives. Many of these actions will take a significant amount of time to complete. Accordingly, we recommend that banks contact information service providers immediately to assess the capability of existing technology payment systems to comply with the Final Rule's requirements. Any necessary technology updates should be identified, implemented and tested as soon as possible. In addition, we recommend that banks have regulatory counsel review and revise their existing overdraft disclosure materials, policies and procedures for compliance with the Final Rule's requirements.

Only through prompt action will banks be able to minimize the amount of disruption and the inevitable decline in overdraft fees that the Final Rule has the potential to create. We hope this article will help banks to understand and quickly react to the Final Rule. If you have questions about any aspect of this article or the Final Rule, or if you would like to discuss with us a review of your bank's overdraft materials for Final Rule compliance, please do not hesitate to contact the author, Stephanie Kalahurka, at (512) 542-5003 or [skalahurka@hunton.com](mailto:skalahurka@hunton.com).



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