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EDITOR'S NOTE: A BUSY OCC
Victoria Prussen Spears

OCC GOES ITS OWN WAY ON NEW COMMUNITY REINVESTMENT ACT REGULATIONS
Jeffrey P. Taft, Stephanie C. Robinson, and Kerri Elizabeth Webb

OCC PROPOSES WIDESPREAD CODIFICATION TO CORPORATE GOVERNANCE RULES FOR NATIONAL BANKS AND FEDERAL ASSOCIATIONS
Douglas P. Faucette

OCC AND FDIC ISSUE FINAL RULES ON "VALID WHEN MADE"
Marc P. Franson

NEWLY ADOPTED VOLCKER RULE AMENDMENTS EXPAND OPPORTUNITIES FOR BANKS TO SPONSOR AND INVEST IN PRIVATE CREDIT FUNDS
Jeff Berman and Eric Bernstein

CLASS ACTION LITIGATION TRENDS WARN OF RENEWED FOCUS ON OVERDRAFT PRACTICES
Abigail M. Lyle and Rachael Craven

PROJECT FINANCE TRANSACTIONS – MANAGING INTEREST RATE RISK
Adam Lapidus

SOME GOOD NEWS FOR THE LOAN INDUSTRY – LOANS ARE NOT SECURITIES
Elliott R. Curzon, John M. Timperio, Michael L. Sherman, David A. Kotler, and Christopher Desmond

ELECTRONIC CLOSINGS: KEY ISSUES FOR BANKS
Michael J. Heller

FEDERAL RESERVE UPDATES TERMS OF MAIN STREET LENDING PROGRAM
Jason D. Navarino, Richard J.L. Lomuscio, and Hannah J. Greendyk

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VOLUME 137 NUMBER 8 September 2020

Editor's Note: A Busy OCC
Victoria Prussen Spears 393

OCC Goes Its Own Way on New Community Reinvestment Act Regulations
Jeffrey P. Taft, Stephanie C. Robinson, and Kerri Elizabeth Webb 396

OCC Proposes Widespread Codification to Corporate Governance Rules for National Banks and Federal Associations
Douglas P. Faucette 406

OCC and FDIC Issue Final Rules on "Valid When Made"
Marc P. Franson 410

Newly Adopted Volcker Rule Amendments Expand Opportunities for Banks to Sponsor and Invest in Private Credit Funds
Jeff Berman and Eric Bernstein 414

Class Action Litigation Trends Warn of Renewed Focus on Overdraft Practices
Abigail M. Lyle and Rachael Craven 423

Project Finance Transactions – Managing Interest Rate Risk
Adam Lapidus 428

Some Good News for the Loan Industry – Loans Are Not Securities
Elliott R. Curzon, John M. Timperio, Michael L. Sherman,
David A. Kotler, and Christopher Desmond 437

Electronic Closings: Key Issues for Banks
Michael J. Heller 444

Federal Reserve Updates Terms of Main Street Lending Program
Jason D. Navarino, Richard J.L. Lomuscio, and Hannah J. Greendyk 450

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Editorial Office
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Class Action Litigation Trends Warn of Renewed Focus on Overdraft Practices

Abigail M. Lyle and Rachael Craven*

Claims have been brought against institutions that believed they were in compliance with the significant overdraft guidance issued by the federal banking agencies since 2005. One place in particular where exposure has expanded is the increased willingness of plaintiff's counsel to challenge the use of form account agreements and disclosures. The authors of this article discuss overdraft practices and provide tips for creating compliant overdraft programs and disclosures.

While overdraft litigation risks have threatened the financial services industry for some time, recent class action lawsuits have trickled down to smaller institutions, including community banks and credit unions. One place in particular where exposure has expanded is the increased willingness of plaintiff's counsel to challenge the use of form account agreements and disclosures, including reliance on Regulation E's model consent form. Particularly concerning is the increase in claims against banks using form disclosure documents created by consulting firms. Specifically, class action plaintiffs have challenged the use of such forms as failing to adequately reflect the institution's actual practices or omitting sufficient detail to disclose the institution's methodology for calculating and assessing overdraft fees. Such alleged deficiencies have been challenged as unfair or deceptive practices and/or breaches of the governing account agreements.

OVERDRAFT PRACTICES

Claims have been brought against institutions that believed they were in compliance with the significant overdraft guidance issued by the federal banking agencies since 2005.[1] These risks are compounded by the fact that the

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[*] Abigail M. Lyle is a partner in the financial services litigation and compliance practice group of Hunton Andrews Kurth, focusing on regulatory compliance and defending financial institutions in enforcement actions and litigation related to consumer protection laws. Rachael Craven is an associate in the firm's financial services litigation and compliance practice group counseling financial institutions and financial service providers in compliance and regulatory matters. Resident in the firm's Dallas office, the authors may be reached at alyle@huntonak.com and rcraven@huntonak.com, respectively.

[1] For example, in 2005, the Federal Reserve, Office of the Comptroller of the Currency, National Credit Union Administration and FDIC issued interagency supervisory guidance for overdraft protection programs, noting general concerns in the marketing, disclosure and

banking agencies have encouraged institutions to consider waiving certain fees, such as overdraft and non-sufficient funds ("NSF") fees,[2] as consumers face financial constraints related to the COVID-19 pandemic. Lawmakers have also proposed legislation that would outlaw overdraft fees during the current pandemic and for any future national emergencies, until at least 120 days after the emergency declaration is lifted.[3]

For institutions that continue to charge overdraft fees in this environment, now more than ever, accountholders (for both consumer and business accounts) must be able to understand how overdraft and NSF fees are assessed and be given a reasonable opportunity to avoid them. Trends from these lawsuits and recent regulatory examination findings include the following areas of increased scrutiny:

- **Multiple Overdraft/NSF Fees on "One Item."** Recent class action suits have challenged the charging of more than one NSF and/or overdraft fee on the same item. These suits are generally based on the premise that the institution's account agreements and/or fee schedules provide that one overdraft or NSF fee will be charged "per item" or "per transaction," but in reality, the same item is eligible to incur multiple overdraft and NSF fees when that item is returned for insufficient funds

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implementation of some overdraft protection programs, *available at* www.federalreserve.gov/boarddocs/SRLETTERS/2005/SR0503a1.pdf. In 2010, the FDIC issued supervisory guidance on overdrafts, noting that institutions must closely monitor and oversee any overdraft payment programs offered to consumers, including taking appropriate measures to mitigate risks, incorporating the best practices in the 2005 Joint Guidance on Overdraft Programs and effectively managing third-party arrangements, *available at* https://www.fdic.gov/news/news/financial/2010/fil10081.pdf. In 2015, the CFPB addressed overdraft programs in its Supervisory Highlights, with a particular emphasis on ledger balance versus available balance methods, *available at* https://files.consumerfinance.gov/f/201503_cfpb_supervisory-highlights-winter-2015.pdf. In 2018, the Federal Reserve issued a publication addressing potential unfair, deceptive or abusive acts or practices (UDAAP) in the context of overdrafts, *available at* https://www.federalreserve.gov/publications/2018-july-consumer-compliance-supervision-bulletin.htm. In June 2019, the FDIC's Consumer Compliance Supervisory Highlights identified potentially unfair or deceptive overdraft practices, including debit card holds and transaction processing, as among the most salient issues observed by examiners, *available at* https://www.fdic.gov/regulations/examinations/consumercomplsupervisoryhighlights.pdf.

[2] *See* Joint Statement on CRA Consideration for Activities in Response to COVID-19, *available at* https://www.fdic.gov/news/news/financial/2020/fil20019a.pdf; *see also* FDIC Statement on Financial Institutions Working with Customers Affected by the Coronavirus and Regulatory and Supervisory Assistance, *available at* https://www.fdic.gov/news/news/financial/2020/fil20017a.pdf.

[3] Stop Overdraft Profiteering during COVID-19 Emergency Act of 2020, S. 3566, 116th Cong. (2020), *available at* https://www.congress.gov/bill/116th-congress/senate-bill/3566.

and later re-presented one or more times. For example, in a recent proposed class action suit against a bank, customers were allegedly charged multiple overdraft and NSF fees, while the plaintiffs contended the account documents stated a single $35 NSF or overdraft fee would be charged on an item if returned or paid into insufficient funds. Attorneys for the class argued the bank's alleged failure to disclose this practice was deceptive and unfair and breached contractual promises, among others.

  - *Practice Tip:* If an item can be subject to multiple overdraft or NSF fees on a "per presentment" as opposed to a "per transaction" or "per item" basis, recent litigation trends caution that such a practice should be clearly disclosed to mitigate against the risk of potential claims.

- **Balance Calculation Methods.** Plaintiff's attorneys, as well as regulators, have also scrutinized the balance calculation methods used by institutions in connection with overdraft programs, including the use of a ledger balance method versus an available balance method. As background, a ledger balance method factors in only settled transactions in calculating an account's balance; an available balance method calculates an account's balance based on electronic transactions that the institutions have authorized (and therefore are obligated to pay) but not yet settled, along with settled transactions. An available balance also reflects holds on deposits that have not yet cleared. In some instances, transactions that would not have resulted in an overdraft (or an overdraft fee) under a ledger balance method may result in an overdraft (and an overdraft fee) under an available balance method. Numerous suits have alleged that institutions failed to adequately explain how account balances are calculated for purposes of assessing, and avoiding, overdraft fees. And, as the U.S. Court of Appeals for the Eleventh Circuit recently made clear, the standalone use of Regulation E's model form A-9 for opt-in overdraft coverage will not absolve institutions from these challenges, as the model form does not address which account balance calculation method is used to determine whether a transaction results in an overdraft.[4]

  - *Practice Tip:* Institutions should carefully disclose the calculation

[4] *See Tims v. LGE Cmty. Credit Union*, 935 F.3d 1228, 1239 (11th Cir. 2019) (finding the model form A-9 language "an overdraft occurs when you do not have enough money to cover a transaction but we pay it anyways" to be ambiguous as to which account balance calculation method was used to determine when an overdraft would occur).

methodology used to determine overdrafts in a clear and unambiguous manner and should not rely solely on Regulation E's model opt-in form to provide for adequate overdraft disclosures.

- **Transaction Processing.** Another common allegation made by plaintiff's attorneys is that the institution unfairly reordered transactions to maximize fees. Because the order in which an institution processes transactions can determine the number of overdraft and NSF fees assessed, the federal banking agencies have recommended that institutions avoid reordering transactions in a way that would take advantage of consumers. Specifically, agencies have indicated that transactions should be processed "in a neutral order that avoids manipulating or structuring processing order to maximize customer overdraft and related fees," adding that "transactions to clear the highest item first is not considered neutral because this approach will tend to increase the number of overdraft fees. By contrast, processing batches of transactions in a random order or order received is a neutral approach; however, institutions should not arrange the order of types of transactions (i.e., batches) cleared in order to increase the number of overdrafts and maximize fees."[5] In one recently settled class action, attorneys for the class argued that a bank's alleged practice of re-ordering and clearing of withdrawals or debits from highest-to-lowest amounts was a deceptive and misleading practice and a breach of the bank's implied duties of good faith and fair dealing owed to its customers. In addition, according to the complaint, the deposit agreement was silent as to the bank's processing policies or otherwise reserved the bank's express discretion over the clearing order of debits or withdrawals.
    - *Practice Tip:* Debits and credits should *not* be processed in a way that maximizes or creates additional overdraft or NSF fees, but rather should be processed in a neutral order. In any event, the posting order should be clearly disclosed and explained so that customers are fully informed as to when and how they may be charged a fee.
- **Customer Disclosures.** Other areas ripe for challenge include whether the customer is fully apprised of the terms and conditions of overdraft protection programs, not only with respect to the charging of multiple fees and the balance calculation and processing methodologies, but also

[5] *See* 2010 FDIC Supervisory Guidance for Overdraft Protection Programs and Consumer Protection and Frequently Asked Questions, *available at* https://www.fdic.gov/news/conferences/overdraft/FAQ.html.

regarding account eligibility standards, the consequences of extensive use, dollar limits and opt-out rights, among others. Certain disclosure practices have also been identified by the federal banking regulators as unfair, deceptive or abusive acts or practices ("UDAAPs") where an institution makes misleading omissions or representations concerning its overdraft program.

- *Practice Tip:* Given the increased litigation risks related to disclosures (or the absence thereof), institutions should carefully and regularly review their account documents to determine if the specific protocols and processes used to assess overdrafts and related fees are clearly disclosed to consumers.

CONCLUSION

We recognize that to further manage overdraft program risks, institutions have been mindful of other best practice recommendations published by the federal banking agencies, including monitoring for excessive and chronic overdraft use, limiting the number of transactions subject to a fee and implementing a *de minimis* threshold in which a fee will not be assessed (e.g., an overdraft fee will not be charged on items $10 or less or on no more than three transactions per day).[6] Such steps, however, have not proven to be enough. Institutions should also be careful when using form documents, such as those provided by third-party vendors, if such documents do not reflect the actual overdraft practices of the institution or do not sufficiently disclose how and when an account will be overdrawn and the circumstances in which a fee may be imposed.

While proper disclosures will necessarily vary, compliant overdraft programs and disclosures must be tailored to the policies and procedures of each institution.

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[6] *See supra,* note 1.