

Consumer Financial Protection Bureau Inquiry Into Overdraft Fees Highlights Focus on “Unfair, Deceptive, or Abusive” Acts or Practices

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The Consumer Financial Protection Bureau is in the midst of a comprehensive effort to obtain comments, proposals, and data from both consumer groups and financial institutions relating to bank account overdraft protection programs. The Bureau’s inquiry is the latest in a series of actions by federal regulators and class action lawyers that have focused attention on bank overdraft practices. The inquiry also highlights the Bureau’s commitment to viewing bank and lender practices through the prism of its power under the Dodd-Frank Act to ban “unfair, deceptive, or abusive acts or practices.” How the Bureau determines what constitutes an unfair, deceptive or abusive act or practice will provide insight into the Bureau’s public policy objectives and its view of its role in the consumer marketplace. Accordingly, both the Bureau’s efforts to regulate overdraft fee practices and its development of a “UDAAP” doctrine bear close watching by the financial services industry.

Background of Overdraft Regulation and Litigation

Financial institutions have long made available to customers overdraft programs through which the institutions pay overdrawn items on behalf of their customers, usually for a fee. These programs protect customers from incurring the costs and embarrassment that are associated with returned checks or declined point-of-sale transactions. Although institutions that offer overdraft programs for checks may do so without express authorization from customers, institutions must have express authorization from customers to pay overdrawn items for ATM and one-time debit transactions.

Initially, banks exercised discretion to cover overdrafts in an *ad hoc* fashion. Starting about ten years ago, however, automated overdraft programs became much more common. In many cases, institutions use proprietary formulas to determine whether to pay a particular item. If the institution pays an overdrawn item, it charges the customer a fee – often the same amount that would be charged if the item had been declined – and the customer must place enough funds in his or her account to pay the fee and the amount of the transaction within a specified period of time.

In addition to protecting customers when they do not have enough funds to pay for a particular transaction, overdraft programs are an important source of revenue for institutions. Along with interchange revenue, many institutions have relied on overdraft revenue to allow them to offer free checking services to their customers. With the reduction in interchange fees as a result of the Durbin Amendment, however, and the recently imposed limits on overdraft fees, revenue has been strained, and many institutions are considering charging higher fees or new fees for other services.

While acknowledging the potential benefits to consumers of overdraft programs, regulators have raised several concerns, including whether overdraft programs take advantage of the most vulnerable customers, and whether institutions have manipulated the programs to maximize profits. To address these concerns, regulators have taken a number of steps over the past few years. These steps include:

- 2005 Joint Agency Guidance regarding overdraft programs, including best practices for offering and marketing overdraft programs and processing transactions;¹
- 2009 final regulations implementing the Electronic Fund Transfer Act to require affirmative consent by consumers for the payment of overdrafts involving ATM and one-time debit card transactions;²
- 2010 FDIC guidance setting forth the FDIC’s expectation that institutions establish, among other things, *de minimis* thresholds for overdrafts before fees are charged and a maximum fee amount per day for overdrawn items.³ The guidance also advises institutions to avoid posting transactions in a manner that would maximize overdraft revenue; and
- 2011 proposed OCC guidance describing “the principles that the OCC expects national banks to follow in connection with any deposit-related consumer credit product.”⁴

At the same time, there has been significant class action litigation challenging overdraft fee programs as unfair and deceptive, in violation of various state laws. Much of this litigation relates to the order in which institutions post transactions, and focuses specifically on the common practice of ordering daily items so that the largest items are paid first. Although this practice makes it less likely that there will be insufficient funds for a particularly important payment, such as a mortgage or car payment, posting larger payments first has the potential to significantly increase the total number of overdrafts, thereby leading to higher fees.

In August 2010, a court ordered a large lender to pay \$203 million for “unfair and deceptive overdraft business practices” relating primarily to the posting order implemented by the bank. In addition, class action lawyers have filed similar actions against many of the largest institutions and several smaller banks. Almost all of these cases have been consolidated into a multi-district litigation in a U.S. district court in Florida.⁵ In one of those actions, the court approved a \$410 million settlement. Settlements of overdraft lawsuits by consumers are likely to exceed well over \$1 billion.

The Bureau’s Notice and Request for Information on Overdraft Practices

Against this backdrop, the Bureau has asked financial institutions and consumers to respond to a Notice and Request for information relating to overdraft programs.⁶ The Notice seeks information that will facilitate the Bureau’s review of existing regulations and supervisory guidance pertaining to overdraft programs. Specifically, the Notice sets forth a number of questions relating to a broad range of topics, including “Lower Cost Alternatives to Overdraft Protection Programs,” “Consumer Alerts and Information Provided Regarding Balances and Overdraft Triggers,” and “The Economics of Overdraft Programs.”

1 Office of the Comptroller of the Currency, et al., Joint Guidance on Overdraft Protection Programs, Docket No. 05-03 (2005).

2 Electronic Fund Transfers, 74 Fed. Reg. 59,033 (Nov. 17, 2009).

3 Federal Deposit Insurance Corporation, FIL-81-2010, Overdraft Payment Programs and Consumer Protection - Final Overdraft Payment Supervisory Guidance (2010).

4 Office of the Comptroller of the Currency, Guidance on Deposit-Related Consumer Credit Products, 76 Fed. Reg. 33,409 (proposed June 8, 2011).

5 *In re Checking Account Overdraft Litig.*, No. 1:09-MD-02036-JLK (S.D. Fla., transferred June 10, 2009).

6 Consumer Financial Protection Bureau, Impacts of Overdraft Programs on Consumers, 77 Fed. Reg. 12,031 (Feb. 28, 2012).

Although the Notice states that the Bureau is seeking information in furtherance of its regulatory authority under the Electronic Fund Transfer Act and the Truth in Savings Act,⁷ the questions presented and a number of statements in the Notice highlight the Bureau's concern with issues that relate directly to potential "unfair, deceptive and abusive acts or practices." For example, the Notice seeks information on the extent to which overdraft fees are assessed to a small group of frequent overdrafters as a means of subsidizing services to other accountholders. The Notice also requests information regarding how institutions monitor – and take steps to prevent – excessive usage by customers, as well as how the posting order in which institutions process transactions affects consumers. Indeed, the question of how institutions "reorder" transactions to maximize profits is particularly prominent in the Notice.

The Bureau's interest in the application of UDAAP to overdrafts is further confirmed by its press release that accompanied the Notice, which summarized four primary concerns: (1) "transaction re-ordering that increases consumer costs," (2) "missing or confusing information," (3) "misleading marketing materials," and (4) "disproportionate impact on low-income and young customers."⁸ Comments in response to the Notice are due by April 30, 2012.

Along with the Notice, the Bureau has also launched a study using data that the Bureau has requested from the largest institutions subject to its supervision, in order to "carry out [its] role of protecting consumers." Finally, the Bureau is seeking public input on a prototype "penalty fee box" that would be included with a customer's checking account statement. The proposed penalty fee box would require institutions to prominently disclose, in large font, the overdraft fees charged in the relevant period, the total amount overdrawn, the number of overdrawn items, the number of days overdrawn, and the year-to-date amount of overdraft fees.

Although many of the disclosures that would be required by the proposed penalty fee box are already required under applicable regulations, the format of the box appears to have been designed by the Bureau to encourage customers to consider alternative products.

Looking Ahead

The fact that the Bureau's inquiry into overdraft practices seeks information relating to a number of potential UDAAP issues is not surprising. The Dodd-Frank Act provides the Bureau with the authority to issue new rules defining what constitutes unfair or deceptive practices, as well as to define the new "abusive" standard in the Act.⁹ Accordingly, since opening its doors in July of last year, the Bureau has made UDAAP a central focus of its mission. To date, however, the Bureau has not indicated when, or even if, it will issue regulations under its UDAAP authority. In the meantime, the Bureau may use its UDAAP authority as a catch-all provision for practices that are not expressly prohibited by other statutes, but that it views as unduly harming consumers.

The Bureau's approach to regulating overdraft fee practices will affect every institution that offers an overdraft program. In addition, institutions that do not offer overdraft programs may be indirectly affected because the Bureau's action likely will have an impact on regulation of other consumer fees. Even more broadly, the manner in which the Bureau addresses overdraft and other fee practices will provide valuable insight into how the Bureau chooses to exercise its UDAAP authority.

7 15 U.S.C. § 1693, *et seq.* and 12 U.S.C. § 4301, *et. seq.* The Dodd-Frank Act grants regulatory authority to the Bureau for relevant sections of the Electronic Funds Transfer Act and the Truth in Savings Act.

8 Press Release, Consumer Financial Protection Bureau, Consumer Financial Protection Bureau Launches Inquiry Into Overdraft Practices (Feb. 22, 2012).

9 12 U.S.C. § 5531.