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Responsible Courtesy Pay Programs

Federal guidance supports building programs that serve members and benefit CUs.

By Barrett Nichols

November 23, 2005

"On Compliance," an online-only Credit Union Management magazine column, runs the fourth Thursday of every month.

Many credit unions have been hesitant to offer courtesy overdraft protection programs to their members because of concerns that these programs do not assist members in practicing good financial behavior. Still, it is abundantly clear that members like these programs and the conveniences they offer—and some even thank their credit unions for charging them a fee to prevent a bounce

On Feb. 18, the Office of Thrift Supervision, Federal Reserve Board, Federal Deposit Insurance Corp., National Credit Union Administration and Office of the Comptroller of the Currency announced final guidance for overdraft protection programs. The regulations are intended to assist credit unions and other financial institutions in setting up and administering responsible courtesy overdraft protection services that don't promote bad personal financial management, but rather support and serve members.

What Does the Guidance Encompass?

Divided into three distinct categories (safety and soundness, legal risks and best practices), the guidance is a "road map" for credit unions to follow and implement a compliant and member-centric courtesy overdraft program.

The safety and soundness category within the guidance urges financial institutions to adopt sufficient written policies and procedures that address credit, operational and other associated risks.

The legal risks category discusses and alerts credit unions to the need to remain in compliance with all applicable federal and state laws. It also recommends that institutions have their courtesy overdraft programs reviewed by legal counsel. This extra step ensures overall compliance before a financial institution implements such a service.

Most important and most relevant to members is the best practices section, which addresses disclosure recommendations, as well as operational processes that need to be designed into these programs (i.e., monitoring program usage, opt-in/opt-out options, etc.) Best practices indemnify members against any fines and penalties that are imposed by any authorized federal or state regulatory agency for improper use of overdraft protection programs.


How Does the Guidance Affect Credit Unions?

The final guidance sets standards for courtesy overdraft programs, making it easier to monitor and manage compliance—credit unions now clearly know what they legally can and cannot do when offering courtesy pay to members.

The guidance provides answers to many questions and concerns which, prior to its release, were addressed in a non-uniform manner. For example, from a safety and soundness standpoint, the guidance confirmed that future charge-offs resulting from overdrafts should be taken into account

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when calculating the allowance for loan and lease losses. From a best practices standpoint, the guidance issued program standards requiring clear disclosure of how customers could opt out of the program.

What Do Credit Unions Need to Know About Regulation DD?

In April 1992, Regulation DD was proposed to implement the Truth in Savings Act, which requires financial institutions to disclose annual percentage yield on accounts, minimum account balance requirements and minimum opening amount requirements. On May 19 of this year, Regulation DD was amended in an effort to improve the uniformity and adequacy of information provided to consumers when they overdraw their deposit accounts, pursuant to a courtesy overdraft protection program. The amendments address the following four areas:

- misleading advertisements,
- non-sufficient funds and overdraft fee disclosure requirements,
- advertisement disclosures and
- periodic statement disclosures for institutions.

The amendments to Regulation DD draw a distinction between financial institutions that "promote the payment of overdrafts" and those that do not. The Federal Reserve Board provides examples of advertisements pertaining to courtesy overdraft programs that would be considered misleading, inaccurate or misrepresent a depository institution's deposit contract. Based on these examples, it seems that including an overdraft limit amount in *any* member communication would be considered "promoting" the payment of overdrafts.

Since the amendments to Regulation DD do not clearly define what "promoting" the payment of overdrafts in an advertisement means, conservative financial institutions should assume that any communication relating to an overdraft courtesy program, outside the "safe harbor" action (listed within Regulation DD), fall into a subjective "gray area" and could be interpreted by regulatory agencies as promoting the payment of overdrafts.

Furthermore, institutions deemed to "promote" the payment of overdrafts would be required to make certain disclosures and separately provide periodic statement reporting. The disclosure statements would include the total amount of fees or charges imposed on the deposit account for paying overdrafts as well as the total amount of fees charged for returning items unpaid.

Is the Guidance Good for Credit Unions?

Despite some negative press, regulators have recognized the value and importance of courtesy overdraft programs. They have, in turn, taken steps to implement practices that will uniformly direct the management of and identify risks associated with this type of service.

Long known for focusing on service, credit unions must use programs that will enhance the member experience. Responsible courtesy overdraft programs should be designed to provide the best service to members, with clear disclosures, not "marketed" to members in a frivolous manner.

The additional fee income generated by courtesy overdraft programs is clear evidence consumers find this a valuable service—one that more and more credit unions may consider offering to meet their members' needs and expectations.

With the issuance of specific guidelines and regulations, the opportunity exists for credit unions to implement responsible courtesy overdraft programs that enhance service levels and strengthen member relationships.

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