

FEDERAL RESERVE ISSUES FINAL RULE ON OVERDRAFT FEES

I. OVERVIEW

New regulations issued by the Board of Governors of the Federal Reserve System (Federal Reserve) will prevent institutions from charging overdraft service fees on ATM or one-time debit card transactions without the opt-in consent of a consumer. This change is contained in a final rule (Final Rule), published in the Federal Register on November 17, 2009, amending Regulation E, which implements the Electronic Fund Transfer Act, 15 U.S.C. 1693 *et seq.* The Final Rule also will require institutions to provide consumers with notice of overdraft services, and to obtain affirmative consent only before charging fees for covering overdrafts on ATM and one-time debit card transactions. The Final Rule also creates a model form for obtaining a consumer's opt-in consent. The Final Rule becomes effective 60 days after publication in the Federal Register (i.e., January 16, 2010), with a mandatory compliance date of July 1, 2010.

II. OPT-IN

The General Opt-In Requirement

The Final Rule requires institutions to provide consumers with the right to consent affirmatively (i.e., opt-in) to the institution's overdraft service for ATM and one-time debit card transactions. Specifically, a financial institution holding a consumer's account may not assess an overdraft fee unless the institution:

- Provides the consumer with notice, segregated from all other information including other account disclosures, describing the institution's overdraft service;
- Provides a reasonable opportunity for the consumer to opt-in;
- Obtains the consumer's opt-in; and
- Provides confirmation of the consumer's opt-in, with a statement informing the consumer of the right to revoke such consent.

Scope of Opt-In Requirement

The opt-in requirement in the Final Rule will apply to circumstances in which an institution assesses a fee for paying an overdraft on any ATM or one-time debit card transaction. The scope of transactions applicable under these circumstances is broad. The opt-in requirement applies not just to overdrafts from ATM withdrawals, but all ATM transactions, including inter-account transfers, bill payments through ATM, and even postage stamp purchases. For one-time debit card transactions, the opt-in requirement applies to any use of the card whether point-of-sale, online,

Brussels

+32 (0)2 290 7800

Denver

+1 303.863.1000

London

+44 (0)20 7786 6100

Los Angeles

+1 213.243.4000

New York

+1 212.715.1000

Northern Virginia

+1 703.720.7000

San Francisco

+1 415.356.3000

Washington, DC

+1 202.942.5000

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or telephone. Any account covered by Regulation E, including payroll card accounts, will be subject to the opt-in requirement to the extent that overdraft fees are imposed on an ATM or one-time debit card transaction. Both new and existing accounts are covered by this opt-in requirement.

The opt-in requirement will NOT apply, however, when an institution pays an overdraft under the following circumstances:

- The overdraft is caused by checks, automated clearinghouse (ACH) transactions, or recurring debits (such as automatic bill payments);
- The overdraft is paid through a consumer's credit card account, home equity line of credit, overdraft line of credit, or a securities/commodities account in which credit is extended by a broker-dealer;
- The overdraft is paid through the transfer of funds from another account of the consumer, whether individually or jointly held;
- The overdraft is caused by an ATM or one-time debit card transaction made with a debit card issued by a third party, but not issued on behalf of the account holding institution; or
- The overdraft does not result in a fee to the consumer.

III. NOTICE REQUIREMENTS

Contents and Format of the Notice

Under the Final Rule, notice of the opt-in requirement can be provided through the published model consent form that accompanies the Final Rule, or other form of notice that is substantially similar. The notice may be in electronic form, if the consumer consents, and such a disclosure would not be subject to the Electronic Signatures in Global and National Commerce Act (E-Sign Act), 15 U.S.C. § 7001 *et seq.* The notice must contain the following elements:

- **Overdraft Service Disclosure.** The notice must contain a brief description of the financial institution's overdraft service and the types of transactions for which a fee or charge for paying an overdraft may be imposed. The Final Rule amends the Official Staff Interpretations to state that the description should also disclose the institution's

policies regarding the payment of overdrafts for other transactions, including checks, ACH transactions, and automatic bill payments as long as this content is not more prominent than the description of the opt-in right for ATM and one-time debit card transactions. Also, the amended Official Staff Interpretations state that an institution should also note if it pays overdrafts at its discretion, and if an overdraft is not paid, then the ATM or one-time debit card transaction will be declined.

- **Fees Imposed.** The notice must contain the amount of all fees imposed by the financial institution for covering an overdraft. This includes the disclosure of all applicable overdraft fees including but not limited to per item or per transaction fees, daily fees, sustained overdraft fees, and negative balance fees.
- **Limits on Fees Charged.** The notice must contain the maximum number of overdraft fees and charges that may be assessed in a day, if applicable. Placing a limit on the number of fees charged, however, is not mandatory under the Final Rule.
- **Disclosure of Opt-In Right.** The notice must contain an explanation of the consumer opt-in right and the methods by which the consumer may consent to the overdraft service.
- **Alternative Overdraft Coverage Plans.** The institution must disclose if it offers either a line of credit service or an account funds transfer service in order to cover overdrafts.

Affirmative Consent and Confirmation

After providing notice, the Final Rule requires that an institution must allow a consumer a reasonable opportunity to consent. A reasonable method of consent can be through a written form that the consumer can complete and mail, a toll-free telephone number, online consent, or a written form that a consumer can complete and present in person at the institution's office. The institution must provide confirmation of the consumer's consent in writing, or electronically if the consumer agrees. This confirmation could consist of either a copy of the consumer's completed opt-in form, or a letter acknowledging the consumer's opt-in.

Segregation of Notice

The consent required under the Final Rule must be obtained separately from other consents or acknowledgements obtained by the institution. Thus, an institution may not simply obtain a consumer's affirmative consent by including language about the overdraft service within a deposit account agreement. Additionally, an institution may not obtain affirmative consent by providing a signature card with a pre-selected check box indicating that the consumer requests the service. If a single consumer on a joint account opts-in, then the consent applies to all overdrafts involving an ATM or debit card transaction for that account.

Consumer Right to Revoke

Consumers have a right to revoke their consent, and this right must be included in the confirmation. An institution may satisfy the requirement by disclosing the right to revoke consent in the initial notice, and sending a consumer the copy of the completed opt-in form. If a consumer revokes his or her consent, then the institution must implement the revocation as soon as reasonably practical. However, the institution does not have to waive or reverse any overdraft fees assessed on the consumer's account prior to the implementation of the revocation request. A single consumer on a joint account may revoke the consent on behalf of the whole account.

Rights of Institution Under Opt-In

The Final Rule makes it clear that a consumer's affirmative consent to opt-in to a financial institution's overdraft service does not create a contractual obligation on the part of the institution to pay any overdrafts on an ATM or one-time debit card transaction. The opt-in simply provides institutions the discretion to pay for an overdraft and charge a fee for this service. An institution may terminate a consumer's access to its overdraft service for any reason, including for example, if the institution determines that there is excessive usage of the service by the consumer. Also, if a financial institution has a policy or practice of declining to authorize and pay any ATM or one-time debit card transactions, with respect to one type of deposit account offered by the institution, and if the institution has a reasonable belief at the time of the authorization request that the consumer does not have

sufficient funds available to cover the transaction, then the account is not subject to the opt-in requirement, even if other accounts at the institution are subject to the rule.

IV. PROVISIONS TO ENSURE CONSUMERS HAVE A MEANINGFUL CHOICE

The Final Rule contains the following two provisions that are intended to ensure that a consumer's decision to opt-in is a meaningful choice and not in any way coerced: (1) a prohibition on conditioning the opt-in; and (2) a prohibition on varying account terms, conditions, and features to disadvantage consumers who do not opt-in.

Prohibition on Conditioning the Opt-In

First, the Final Rule prevents institutions from discriminating against consumers who do not opt-in. It prohibits institutions from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions on the consumer also opting in to the institution's payment of overdrafts for ATM and one-time debit card transactions. The Final Rule amends the Official Staff Interpretations to state that an institution must apply the same criteria for deciding when to pay overdrafts for checks, ACH transactions, and other types of transactions whether or not a consumer has opted-in to the institution's overdraft service with respect to ATM and one-time debit card overdrafts.

The Final Rule notes that the Federal Reserve's consumer testing shows that many consumers would prefer that their financial institutions cover overdrafts by check, ACH, or automatic bill pay. The Federal Reserve indicated that permitting conditioning could cause some consumers to feel compelled to opt-in so that they could avail themselves of check, ACH, or automatic bill pay overdraft services.

Prohibition on Varying Account Terms, Conditions, and Features

The Final Rule also prohibits institutions from varying account terms, conditions, and features for consumers who do not opt-in to the institution's overdraft service for ATM and one-time debit card transactions. The Federal Reserve expressed concern that institutions could otherwise compel the consumer to opt-in by providing consumers who do not opt-in with less favorable terms, conditions, or features than

consumers who do opt-in. The prohibition includes, but is not limited to, (1) interest rates paid and fees assessed; (2) the type of ATM or debit card provided to the consumer; (3) minimum balance requirements; or (4) account features such as online bill payment services.

V. MANDATORY COMPLIANCE DATE

The Final Rule sets an effective date of 60 days after publication in the Federal Register (i.e., January 16, 2010), with a mandatory compliance date of July 1, 2010.

- **Existing Account Holders.** For accounts opened prior to July 1, 2010, an institution may not assess any fees or charges on the consumer's account on or after August 15, 2010 for paying an ATM or one-time debit card transaction pursuant to the institution's overdraft service unless the institution has obtained the consumer's affirmative consent. If an existing account holder expresses a desire not to opt-in before August 15, 2010, the institution would be expected to honor the consumer's choice at the time.
- **New Account Holders.** For accounts opened after July 1, 2010, an institution must obtain the consumer's affirmative consent before it may assess any fee or charge on the consumer's account for paying an ATM or one-time debit card transaction pursuant to the institution's overdraft service.
- **No Retroactive Consent.** If a consumer overdraws his or her account, the Final Rule does not permit an institution to obtain the consumer's affirmative consent subsequent to the overdraft and apply that consent retroactively to the prior overdraft.

VI. TOPICS NOT ADDRESSED IN THE FINAL RULE

The Final Rule specifically mentions topics that the Federal Reserve decided to reserve for future consideration including debit holds, real-time opt-in notices, and other possible consumer protections.

Debit Holds

The Final Rule does not contain a provision on debit holds, as a result of a number of significant operational concerns

raised by commentators about debit holds. This is despite the fact that the Proposed Rule contained a safe harbor that would have allowed a financial institution to assess a fee or charge for paying an overdraft that is caused solely by a debit hold in certain cases.¹ The safe harbor would have applied to institutions that had procedures and practices designed to remove the debit hold within a reasonable period of time (i.e., within two hours of authorization). The Final Rule states that the Federal Reserve will continue to monitor developments with respect to debit holds and assess whether to take further action at a later date.

Real-Time Notices

Some industry commentators urged the Federal Reserve to allow institutions to offer the consumer the ability to opt-in to the institution's overdraft service on a transaction-by-transaction basis, if technologically feasible. The Final Rule does not address real-time notices because the Federal Reserve does not believe that they are technologically feasible in many locations, particularly at ATMs and merchant point-of-sale terminals. Nevertheless, the Final Rule indicates that the Federal Reserve will continue to monitor developments in real-time notice capability and assess whether such notice would enhance consumer protection.

Other Consumer Protections

The Final Rule states that the Federal Reserve recognizes that additional consumer protections may be appropriate with respect to overdraft services, such as rules to address transaction posting order, and therefore the Federal Reserve intends to continue assessing whether additional regulatory action relating to overdraft services is needed.

Congress is currently considering proposed legislation to protect customers from excessive checking account overdraft fees.² The proposed bills would, among other things, (1) limit the number of fees that can be charged in specific timeframes; (2) require that fees be proportional to the cost of processing the overdraft;

¹ A debit hold occurs when an institution places a block, or hold, on a consumer's account when a consumer uses a debit card to make a purchase in order to ensure the consumer's account has sufficient funds in it when the transaction is presented for settlement.

² See The Fairness and Accountability in Receiving Overdraft Coverage Act of 2009 (S. 1799); Overdraft Protection Act of 2009 (H.R. 3904).

(3) prohibit manipulation of posting order for the purpose of increasing the fees charged on a customer; and (4) prohibit fees if an overdraft is due solely to a bank hold. These bills would create limits on institutions that are much stricter than the Final Rule. Although the bills were introduced before the publication of the Final Rule, neither Senator Christopher Dodd nor Representative Barney Frank have expressed interest in tabling the bills within their respective Congressional financial committees.

VII. OUTLOOK

Under the current climate, this Final Rule may represent only one in a series of consumer protection initiatives to be implemented by the Federal Reserve and Congress. Notwithstanding the fact that this Final Rule may be only the beginning, it will have consequences to both institutions and consumers. Institutions will certainly see a reduction in the amount of fees they collect for overdrafts. This reduction will provide relief to consumers most prone to incurring multiple overdraft charges. Consumers as a whole, alternatively, may see a reduction in account services subsidized by overdraft fees. Institutions may reduce their offerings of account features such as maintenance fee-free checking accounts or free online bill payment due to cost concerns. Additionally, fees for overdrafts on all accounts could possibly experience increases. One consequence of the Final Rule is certain; more consumers will be denied authorization to overdraft their accounts when making debit card purchases and transactions at an ATM. The Federal Reserve and others believe that many consumers prefer this denial to overdraft coverage, and the implementation of the Final Rule will determine whether they are correct in this regard.

We would be pleased to assist any financial institutions in adapting their business practices to these significant regulatory changes. We are available to review and modify marketing, disclosure, billing, and servicing practices to ensure compliance with the Final Rule. We have extensive experience in the account disclosure regulatory area, and can assist in assessing the impact of the Final Rule, and the landscape upon which your business must now operate. If you have any questions about the Final Rule, please contact your Arnold & Porter LLP attorney or:

Michael B. Mierzewski

+1 202.942.5995

Michael.Mierzewski@aporter.com

Beth S. DeSimone

+1 202.942.5445

Beth.DeSimone@aporter.com

Jeremy W. Hochberg

+1 202.942.5523

Jeremy.Hochberg@aporter.com

Brian P. Larkin

+1 202.942.5990

Brian.Larkin@aporter.com