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Proposed Changes to Regulation E to Limit Assessment of Overdraft Fees for ATM and Debit Card Transactions

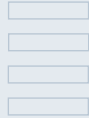
The Board of Governors of the Federal Reserve System (the “Board”) is soliciting comments to a proposed rule amending Regulation E, which implements the Electronic Fund Transfer Act. The amendments would limit the ability of all depository institutions and state-chartered credit unions (“financial institutions”) to assess overdraft fees for honoring ATM withdrawals and one-time debit card transactions that overdraw the customer’s account. In addition, the amendments would prohibit a financial institution from assessing an overdraft fee for paying an overdraft if the overdraft was caused by a debit hold placed on the account by the financial institution. The proposed rule also contains a number of detailed proposals regarding the actual implementation and operation of the amendments. The amendments as a whole, if adopted, would potentially require significant operational changes with respect to a financial institution’s overdraft policies and procedures and may require reprogramming of its operating systems to enable it to identify transactions subject to the new rules.

The proposed amendments apply to withdrawals from both proprietary and non-proprietary ATMs and to any one-time debit card transaction, whether the transaction is a point of sale transaction, online transaction or telephone transaction. The proposed amendments do not apply to overdraft services provided in connection with check transactions or ACH transactions. Comments to the proposed amendments must be received by the Board by March 30, 2009.

The proposed amendments address concerns expressed about the practice of some financial institutions of providing overdraft coverage without the customer’s knowledge or consent and then charging an overdraft fee, which in many cases exceeds the amount of the overdraft. Consumer groups argue that by honoring overdrafts on ATM and debit card transactions, financial institutions are encouraging customers to rely on the overdraft services and that, in the long run, customers will incur greater costs than if the transactions were not honored. The Board is considering two alternative approaches to address these issues. The first approach would prohibit a financial institution from charging an overdraft fee unless the customer fails to opt out of overdraft coverage after being given notice of the right to opt out. The alternative approach would prohibit a financial institution from charging an overdraft fee unless the customer affirmatively opts in and agrees to the overdraft coverage. A customer’s election to forego a financial institution’s overdraft service does not prevent the financial institution from providing

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overdraft coverage; however, under the proposed amendments, a financial institution generally would not be able to charge the customer a fee unless one of the enumerated exceptions applies, such as where the financial institution has a reasonable belief that there are sufficient funds in the account at the time it authorizes a transaction, but it turns out that the funds are not sufficient. In addition, nothing in the amendments prevents a financial institution from ultimately debiting the account for the full amount of the transaction once sufficient funds are available.

Under the opt out approach, a financial institution may not assess any overdraft fee unless: (1) the financial institution provided the customer with notice of the right to opt out of the overdraft coverage; (2) the financial institution gave the customer a reasonable opportunity to opt out of the coverage; and (3) the customer did not opt out. The notice would be given at account opening and subsequently for each periodic statement cycle in which a fee may be assessed for overdraft coverage. The Board is currently considering several different proposals as to what would constitute a reasonable opportunity to opt out of overdraft coverage.

Under the opt in approach, financial institutions would be required to provide customers with notice of the right to opt in to overdraft coverage and an overdraft fee could not be charged unless the customer had affirmatively consented to the overdraft coverage. If the customer opts in, the financial institution would be required to provide written confirmation of the customer's consent. Subsequent notices after an overdraft fee was charged would not be required once a customer opted in to overdraft coverage. The Board is currently considering proposals as to what would constitute a reasonable method of opting in to overdraft coverage.

The proposed amendments would also prohibit a financial institution, under most circumstances, from assessing an overdraft fee in any situation where the overdraft would not have occurred but for a debit hold placed on the account in an amount that exceeds the actual transaction amount. When a customer uses a debit card to make a purchase, many financial institutions immediately place a "debit hold" on the account to ensure that the customer has sufficient funds in the account when the transaction is presented for settlement. Often times, because the financial institution does not know the actual amount of the transaction at the time the transaction is authorized (for instance, where a debit card is used to purchase gas), the financial institution will place a debit hold on the account in excess of the amount of the transaction. As a result, the customer may engage in a subsequent transaction thinking that there are sufficient funds available but, because of the debit hold, the transaction creates an overdraft. In these situations, the financial institution would be prohibited from assessing an overdraft fee. The proposed amendments would not apply to transactions where the amount of the debit hold is equal to or less than the actual amount of the transaction or where the actual amount of the transaction would also have caused an overdraft.

As noted, comments to the proposed amendments must be received by the Board no later than March 30, 2009.

If you would like additional information concerning the proposed amendments, or would like assistance in providing comments to the Board, please feel free to contact the attorneys in the Financial Institutions and Lending Practice Area of Hiscock & Barclay, LLP. ■

If you require further information regarding the information presented in this Legal Alert and its impact on your organization, please contact any of the members of the Practice Area listed on the front of this Alert.