Federal Deposit Insurance Corporation

Table of Contents

Supervisory Guidance on Multiple Re-Presentment NSF Fees

August 2022
(Revised June 2023)

The Federal Deposit Insurance Corporation (FDIC) is issuing guidance to ensure that supervised institutions are aware of the consumer compliance risks associated with assessing multiple non-sufficient funds (NSF) fees arising from the re-presentment of the same unpaid transaction. Additionally, the FDIC is sharing its supervisory approach where a violation of law is identified and full corrective action is expected.

Background

Many financial institutions charge NSF fees when checks or Automated Clearinghouse (ACH) transactions are presented for payment, but cannot be covered by the balance in a customer's transaction account. After receiving notice of declination, merchants may subsequently resubmit the transaction for payment. Some financial institutions charge additional NSF fees for the same transaction when a merchant re-presents a check or ACH transaction on more than one occasion after the initial unpaid transaction was declined. In these situations, there is an elevated risk of violations of law and harm to consumers.

During consumer compliance examinations, the FDIC has identified violations of law when financial institutions charged multiple NSF fees for the re-presentment of unpaid transactions. The FDIC found that some disclosures provided to customers did not fully or clearly describe the institution's re-presentment practice, including not explaining that the same unpaid transaction might result in multiple NSF fees if an item was presented more than once.

Potential Risks Arising from Multiple Re-Presentment NSF Fees

<u>Consumer Compliance Risk</u>: Practices involving the charging of multiple NSF fees arising from the same unpaid transaction results in heightened risks of violations of Section 5 of the Federal Trade Commission (FTC) Act, which prohibits unfair or deceptive acts or practices (UDAP). While specific facts and circumstances ultimately determine whether a practice violates a law or regulation, the failure to disclose material information to customers about re-presentment and fee practices has the potential to mislead reasonable customers, and there are situations that may also present risk of unfairness if the customer is unable to avoid fees related to re-presented transactions.[1]

- <u>Deceptive Practices</u>: In a number of consumer compliance examinations, the FDIC determined that if a financial institution assesses multiple NSF fees arising from the same transaction, but disclosures do not adequately advise customers of this practice, the misrepresentation and omission of this information from the institution's disclosures is

[1] These practices may also violate Section 1036(a)(1)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. § 5536(a)(1)(B)), which prohibits any covered person or service provider from engaging in, among other things, abusive acts or practices in connection with a consumer financial product or service.

material. The FDIC found that if this information is not disclosed clearly and conspicuously to customers, the material omission of this information is considered to be deceptive pursuant to Section 5 of the FTC Act.

- Unfair Practices: In certain circumstances, a failure to adequately advise customers of fee practices for re-presentments raises unfairness concerns because the practices may result in substantial injuries to customers; the injury may not be reasonably avoidable; and there may be no countervailing benefits to either customers or competition. In particular, a risk of unfairness may be present if multiple NSF fees are assessed for the same transaction in a short period of time without sufficient notice or opportunity for customers to bring their account to a positive balance in order to avoid the assessment of additional NSF fees. While revising disclosures may address the risk of deception, doing so may not fully address the unfairness risks.

Third-Party Risk: Third parties, including core processors, often play significant roles in processing payments, identifying and tracking re-presented items, and providing systems that determine when NSF fees are assessed. Such third-party arrangements may present risks if not properly managed. Institutions are expected to maintain adequate oversight of third-party activities and appropriate quality control over products and services provided through third-party arrangements.[2] In addition, institutions are responsible for identifying and controlling risks arising from third-party relationships to the same extent as if the third-party activity was handled within the institution. Institutions are encouraged to review and understand the risks presented from their core processing system settings related to multiple NSF fees, as well as understand the capabilities of their core processing system(s), such as identifying and tracking re-presented items and maintaining data on such transactions.

Litigation Risk: Multiple NSF fee practices may result in heightened litigation risk. Numerous financial institutions, including some FDIC-supervised institutions, have faced class action lawsuits alleging breach of contract and other claims because of the failure to adequately disclose re-presentment NSF fee practices in their account disclosures. Some of these cases have resulted in substantial settlements, including customer restitution and legal fees.

Risk Mitigation Practices

Institutions are encouraged to review their practices and disclosures regarding the charging of NSF fees for re-presented transactions. The FDIC has observed various risk-mitigating activities that financial institutions have taken to reduce the potential risk of consumer harm and avoid potential violations of law regarding multiple re-presentment NSF fee practices. These include:

- Eliminating NSF fees.

- Declining to charge more than one NSF fee for the same transaction, regardless of whether the item is re-presented.

[2] FIL-29-2023, "Interagency Guidance on Third-Party Relationships: Risk Management" (June 6, 2023).

- Conducting a comprehensive review of policies, practices, and monitoring activities related to re-presentments and making appropriate changes and clarifications, including providing revised disclosures to all existing and new customers.

- Clearly and conspicuously disclosing the amount of NSF fees to customers and when and how such fees will be imposed, including:
  - Information on whether multiple fees may be assessed in connection with a single transaction when a merchant submits the same transaction multiple times for payment;
  - The frequency with which such fees can be assessed; and
  - The maximum number of fees that can be assessed in connection with a single transaction.

- Reviewing customer notification or alert practices related to NSF transactions and the timing of fees to ensure customers are provided with an ability to effectively avoid multiple fees for re-presented items, including restoring their account balance to a sufficient amount before subsequent NSF fees are assessed.

If institutions self-identify re-presentment NSF fee issues, the FDIC expects supervised financial institutions to:

- Take full corrective action, including providing restitution to harmed customers, consistent with the restitution approach described in this guidance;

- Promptly correct NSF fee disclosures and account agreements for both existing and new customers, including providing revised disclosures and agreements to all customers;

- Consider whether additional risk mitigation practices are needed to reduce potential unfairness risks; and

- Monitor ongoing activities and customer feedback to ensure full and lasting corrective action.

FDIC's Supervisory Approach

When exercising supervisory and enforcement responsibilities regarding multiple re-presentment NSF fee practices, the FDIC will take appropriate action to address consumer harm and violations of law. The FDIC's supervisory response will focus on identifying re-presentment related issues and ensuring correction of deficiencies and remediation to harmed customers, when appropriate.

In reviewing compliance management systems, the FDIC recognizes an institution's proactive efforts to self-identify and correct violations. Examiners will generally not cite UDAP violations that have been self-identified and fully corrected prior to the start of a consumer compliance examination.[3] In addition, in determining the scope of any restitution requested, the FDIC will consider the likelihood of substantial consumer harm from the practice as well as an institution's

[3] Page II-6.4 of the FDIC's Consumer Compliance Examination Manual.

record keeping practices and any challenges an institution may have with retrieving, reviewing, and analyzing transaction data or other information about the frequency and timing of re-presentment fees.[4]

If examiners identify violations of law due to re-presentment NSF fee practices that have not been self-identified and fully corrected prior to a consumer compliance examination, the FDIC will evaluate appropriate supervisory or enforcement actions, including civil money penalties and restitution, where appropriate.

[4] The FDIC has generally accepted a two-year lookback period for restitution in instances where institutions have been unable to reasonably access accurate ACH data for re-presented transactions. In addition, based on the on-going and extensive challenges observed in accurately identifying re-presented transactions through core processing systems, the FDIC does not intend to request an institution to conduct a lookback review absent a likelihood of substantial consumer harm.

Supervisory Guidance on Charging Overdraft Fees for Authorize Positive, Settle Negative Transactions

The Federal Deposit Insurance Corporation (FDIC) is issuing guidance to ensure that supervised institutions are aware of the consumer compliance risks associated with charging an overdraft fee on a transaction that was authorized against a positive balance but settled against a negative balance, a practice commonly referred to as "Authorize Positive, Settle Negative" (APSN). The FDIC previously identified concerns with this practice in its June 2019 Consumer Compliance Supervisory Highlights.[1] This guidance expands on the 2019 Supervisory Highlights article by discussing the FDIC's concerns with both the available and ledger balance methods used by institutions when assessing overdraft fees. This guidance also clarifies that disclosures describing transaction processing may not mitigate these concerns.

Background

Overdraft programs, transaction clearing, and settlement processes are complex. In the case of APSN transactions, which involve consumers being assessed overdraft fees for transactions where they had sufficient account balances at the time the transactions were initiated, it may not be possible for consumers to determine when fees will be assessed and how they may be avoided.

Financial institutions' processing systems generally use either a ledger balance method[2] or an available balance method,[3] including for the purpose of assessing overdraft-related fees. An account's available balance may be impacted by pending debit transactions.[4] Some banks assess overdraft fees on debit card transactions that authorize when a customer's available balance is positive but later post to a customer's account when their balance is negative. In this scenario, a customer's account has a sufficient available balance to cover a debit card transaction when the transaction is authorized but, due to one or more intervening transactions, has an insufficient balance to cover the transaction at the time it settles.[5]

In addition to assessing an overdraft fee on the APSN transaction, some banks also assess overdraft fees on intervening transactions that exceed the customer's account balance. In this

[1] Consumer Compliance Supervisory Highlights (June 2019).
[2] A ledger balance method calculates the account balance based only on transactions settled during the relevant period and does not take into account authorization holds. This method typically correlates to the balance reflected on a consumer's periodic statement.
[3] An available balance method calculates the account balance based on authorized (but not settled) transactions the financial institution is obligated to pay under contractual or other obligations, as well as settled transactions and pending deposits. The available balance is generally the amount of money/funds the consumer can access because it accounts for any pending debit or credit transactions. This balance typically correlates to the balance accessible to consumers online, through a mobile application, at an ATM, or by phone.
[4] This type of authorization hold is sometimes referred to as a debit hold, a temporary debit authorization hold, or a preauthorization.
[5] Refer to Table 1 in the Consumer Financial Protection Bureau's Consumer Financial Protection Circular 2022-06, "Unanticipated overdraft fee assessment practices" (Oct. 26, 2022) (CFPB Circular 2022-06).

scenario, for example, the bank reduces a customer's balance to account for the initial authorized debit card transaction, and subsequently, an intervening transaction further reduces the customer's available balance so that the account no longer has a sufficient balance. The bank charges an overdraft fee on both the intervening transaction and the initial APSN transaction when posted to the customer's account.[6]

During consumer compliance examinations, the FDIC has determined that certain overdraft practices related to APSN transactions were unfair.

Potential Risks

Failure to take steps to avoid assessing overdraft-related fees when transactions are authorized on positive balances but settle on negative balances results in heightened risks of violations of Section 1036(a)(1)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. § 5536(a)(1)(B)), which prohibits any covered person or service provider from engaging in any unfair, deceptive, or abusive acts or practices in connection with a consumer financial product or service (Dodd-Frank UDAAP) and Section 5 of the Federal Trade Commission (FTC) Act, which prohibits unfair or deceptive acts or practices (FTC UDAP).[7] The FDIC applies the same standards as the Consumer Financial Protection Bureau (CFPB) and FTC in determining whether an act or practice is unfair under the respective statutes. An act or practice is unfair when it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair.

Unanticipated and unavoidable overdraft fees can cause substantial injury to consumers. A consumer is likely to suffer injury when charged more overdraft fees than may have been anticipated based on the consumer's actual spending. While not all overdraft fees may be attributable to APSN transactions, the likely presence of intervening transactions may cause additional injury.

The consumer cannot reasonably avoid the injury because the consumer does not have the ability to effectively control payment systems and overdraft processing systems practices. Due to the complicated nature of overdraft processing systems and payment system complexities outside the consumer's control, consumers may be unable to avoid injury. Additionally, in some cases, the institutions' methodology for assessing overdraft fees on APSN transactions resulted in unanticipated and unavoidable overdraft fees that were not outweighed by a countervailing benefit to consumers or competition. Dodd-Frank UDAAP and FTC UDAP risks exist in both available balance and ledger balance methods of assessing overdraft fees, but may be more pronounced in situations where institutions use available balance methods. For example, the use of available balance to assess overdraft fees may exacerbate the injury, as temporary holds may

[6] Refer to Table 2 in CFPB Circular 2022-06.

[7] For information on how the authorize positive, settle negative practices relate to the Dodd-Frank Act's prohibition on unfair, deceptive, or abusive acts or practices, refer to the CFPB Circular 2022-06. Nothing in this guidance should be read as inconsistent or in conflict with the CFPB Circular in the application of Dodd-Frank UDAAP.

lead to consumers being assessed multiple overdraft fees when they may have reasonably expected only one.

Risk Mitigation Practices

Institutions are encouraged to review their practices regarding the charging of overdraft fees on APSN transactions to ensure customers are not charged overdraft fees for transactions consumers may not anticipate or avoid.

Third parties often play significant roles in processing transactions, identifying and tracking balances at the time of authorization, and providing systems that determine when overdraft fees are assessed. Institutions should ensure overdraft programs provided by third parties are compliant with all applicable laws and regulations. Such third-party arrangements may present risks if not properly managed by financial institution management. Institutions are encouraged to review these third party arrangements, as institutions are expected to maintain adequate oversight of third-party activities and appropriate quality control over products and services provided through third-party arrangements.[8] Institutions are also encouraged to review and understand the risks presented from third-party system settings for overdraft-related fees, as well as understand the capabilities of their core processing system(s), such as identifying and tracking transactions authorized on a positive balance but settled on a negative balance and maintaining data on such transactions. Some third parties offer data processing system enhancements aimed at preventing overdraft-related fees from being charged for a transaction when a debit hold authorizes against a positive balance. Note that some third parties may offer these enhancements as optional or require client financial institutions to take action in order to implement them.

In addition, institutions are also generally encouraged to review disclosures and account agreements to ensure the financial institution's practices for charging any fees on deposit accounts are communicated accurately, clearly, and consistently. However, disclosures generally do not fully address Dodd-Frank UDAAP and FTC UDAP risks associated with APSN transactions and related overdraft fees.

[8] FIL-44-2008, "Guidance for Managing Third-Party Risk" (June 6, 2008).

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Risk Management Supervision
Division of Complex Institution Supervision and Resolution

October 24, 2023

TO: Board of Directors

FROM: Doreen R. Eberley
Director

Jim McGraw
Acting Director

SUBJECT: Proposed Revisions to the FDIC's Section 19 Regulations

EXECUTIVE SUMMARY

The Divisions of Risk Management Supervision (RMS) and Complex Institution Supervision and Resolution (CISR) recommend that the Board of Directors (Board) revise regulations concerning Section 19 of the Federal Deposit Insurance (FDI) Act to conform to the Fair Hiring in Banking Act (FHBA). (The FHBA is contained within the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Pub. L. No. 117-263, § 5705.) The FHBA became effective on December 23, 2022. Among other provisions, the FHBA excluded or exempted categories of otherwise covered offenses from the scope of Section 19, including certain older offenses and "designated lesser offenses." The FHBA also clarified several definitions in Section 19 and provided application-processing procedures. Staff considers most of the proposed revisions to the Section 19 regulations to be required by the FHBA. Other proposed revisions reflect the FDIC's interpretation of Section 19 in light of the FHBA. The proposed revised regulations are attached as Exhibit A. In addition, RMS and CISR recommend that the Board authorize the General Counsel and Executive Secretary to publish the Notice of Proposed Rulemaking in the *Federal Register*, attached as Exhibit B, which describes the proposed changes in detail. Exhibit C is the revised statutory text.

The FDIC will solicit comments on all aspects of its interpretation of the proposed changes to Section 19. In addition, it will request comments as to specific questions regarding the following topics: the appropriate offense date for a covered offense; the definition of the phrase "sentencing occurred"; whether Section 19 encompasses foreign convictions and pretrial diversions; the standard for expungements, sealings, and dismissals; the degree to which Section 19 covers offenses involving controlled substances; and *de minimis* offenses. By seeking public comment, the FDIC can consider the views of the industry and other interested parties about the appropriateness and functionality of the proposed changes to the regulations and help clarify the definitions of key terms contained in the FHBA.

Concur:

____
Harrel M. Pettway

BACKGROUND

Section 19 of the FDI Act, 12 U.S.C. § 1829 (Section 19), prohibits, without the prior written consent of the FDIC, a person convicted of any criminal offense involving dishonesty, breach of trust, or money laundering, or who has entered into a pretrial diversion or similar program in connection with a prosecution for such an offense (collectively, covered offenses), from becoming or continuing as an institution-affiliated party; owning or controlling, directly or indirectly, an insured institution; or otherwise participating, directly or indirectly, in the conduct of the affairs of an insured institution. Further, the law forbids an insured institution from permitting such a person to engage in any conduct or to continue any relationship prohibited by Section 19.

From 1998 until 2020, the FDIC had a Statement of Policy that was issued under Section 19, occasionally revised, and published in the *Federal Register*. The purpose of the Statement of Policy was to "provide[] the public with guidance relating to section 19 and the FDIC's application of this statute."[1] In 2020, following notice and comment, the FDIC revised and codified the Statement of Policy into the FDIC's Filing Procedures under part 303, subpart L, and Rules of Practice and Procedure under part 308, subpart M.[2]

On December 23, 2022, the President signed into law the FHBA, which significantly revised Section 19 and was effective immediately. The notable changes to Section 19 under the FHBA are discussed below.

ANALYSIS OF THE PROPOSED AMENDMENTS

The proposed revisions to the FDIC's Section 19 regulations are primarily intended to align the regulations with the FHBA's provisions. The proposed revisions address, among other topics, the types of offenses covered by Section 19, the effect of the completion of sentencing or pretrial-diversion program requirements in the context of Section 19, and the FDIC's procedures for reviewing applications filed under Section 19. The preamble to the *Federal Register* Notice for the proposed rulemaking details these changes. The most significant changes to the Section 19 regulations due to the FHBA, in staff's view, are as follows.

Certain older offenses. The FHBA excludes certain offenses from the scope of Section 19 based on the amount of time that has passed since the offense occurred or since the individual was released from incarceration. If an individual has a covered offense and (1) it has been seven years or more since the offense occurred[3] or (2) the individual was incarcerated with respect to the offense and it has been five years or more since the individual was released from incarceration, the Act excludes such an offense from the scope of Section 19.[4] That is, no

---

[1] *See* 85 Fed. Reg. 51,312, 51,312 (Aug. 20, 2020) (Final Rule revising and codifying the Statement of Policy into the Code of Federal Regulations).
[2] *See id.*
[3] Legal staff interprets the term "offense occurred" to mean the "last date of the underlying misconduct." In instances with multiple offenses, "offense occurred" means the last date of any of the underlying offenses.
[4] 12 U.S.C. § 1829(c)(1)(A).

consent application is required. Moreover, if an individual (1) committed a covered offense when the individual was 21 years of age or younger and (2) if it has been more than 30 months since the sentencing for that offense occurred, the Act excludes the offense from the scope of Section 19.[5] All of these revisions mark a paradigm shift concerning Section 19. Until the passage of the FHBA, individuals with covered offenses on their records faced potentially a lifetime ban from banking without the FDIC's consent. The revised language means that all state offenses and the vast majority of federal offenses will be removed from the scope of Section 19 after seven years—at the latest.

Expunged, sealed, and dismissed criminal records. The Act excludes certain convictions from the scope of Section 19 that have been expunged, sealed, or dismissed.[6] The FDIC's current regulations contain interpretative language concerning such offenses, but the statute has now codified the notion that certain expunged, sealed, or dismissed convictions are excluded from the scope of Section 19. The proposed rule would modestly broaden the statutory language concerning such offenses. The statute addresses expungements, sealings, or dismissals through court order; it is silent as to such actions by operation of law. The proposed rule would include expungements and sealings by operation of law, which would harmonize the FDIC's current regulations concerning expunged and sealed records with the statutory language and provide a more comprehensive framework as to such records.

Designated lesser offenses. The FHBA excludes certain "lesser offenses" from the scope of Section 19 including the use of fake identification, shoplifting, trespass, fare evasion, driving with an expired license or tag (and such other low-risk offenses as the FDIC may designate), if one year or more has passed since the applicable conviction or program entry.[7]

Criminal offenses involving dishonesty. The FHBA excludes certain offenses from the definition of "criminal offenses involving dishonesty," including (1) misdemeanor criminal offenses committed more than one year before the date on which an individual files an application, excluding any period of incarceration, and (2) "an offense involving the possession of controlled substances."[8] Historically, the FDIC has required an application as to drug-related offenses—aside from simple-possession offenses.[9] The rationale the FDIC has relied on has been that such non-simple-possession offenses (e.g., trafficking and manufacturing) inherently involve dishonesty, breach of trust, or money laundering. In light of the FHBA, however, staff believes that Congress intended to exclude, *at least*, the offenses of simple possession and possession with intent to distribute from the "involving dishonesty" category because of the statute's use of the phrase "involving the possession of controlled substances." Additionally, staff believes that the FDIC should shift from the presumption that other drug-related offenses are necessarily subject to Section 19 as crimes involving dishonesty, breach of trust, or money laundering. It is *possible* that the elements of a drug-related crime could implicate one of those three categories

[5] 12 U.S.C. § 1829(c)(1)(B). The statutory revisions concerning all of these older offenses do not affect the specific federal offenses listed under 12 U.S.C. § 1829(a)(2) (e.g., money laundering).
[6] *See* 12 U.S.C. § 1829(c)(2).
[7] 12 U.S.C. § 1829(c)(3)(D).
[8] 12 U.S.C. § 1829(g)(2)(C).
[9] *See* 85 Fed. Reg. at 51,313 ("The FDIC maintains that an application is required for it to determine the nature of the offense and elements of the crime and therefore it will continue the current requirement that an application be filed, unless the offense is *de minimis*.")

(and if so, an application would be required), but it is not *necessarily* so. Because this proposed rulemaking implements the new statutory language concerning "involving possession," this proposed rulemaking provides an opportunity for the FDIC to treat drug offenses the same as all other types of crimes—which do not automatically trigger the need for an application. Moving away from that presumption of coverage under Section 19 would also align the FDIC with the FRB's treatment of drug-related offenses; the FRB does not presume that drug-related offenses are subject to Section 19 and instead looks at the statutory elements of such crimes like any other form of criminal conduct.

Standards for FDIC review of Section 19 applications. The FHBA prescribes standards for the FDIC's review of applications submitted under Section 19.[10]

The proposed rule seeks public comment and would provide for a 60-day comment period. By seeking public comment on the proposed revisions, the Agency may receive input from the banking industry and interested parties about how the FDIC could better apply the requirements of Section 19, areas of confusion for the public and industry, or other feedback that would be useful in the Agency's exercise of its statutory obligations. The FDIC will consider such comments and may make changes to the regulations based upon such feedback.

Lastly, the FHBA requires the FDIC to "consult and coordinate" with the NCUA "as needed to promote consistent implementation [of the Act] where appropriate."[11] Accordingly, throughout this year, staff has worked with staff from the NCUA, as well as staff from the FRB and OCC, in an effort to ensure consistent interpretation and implementation of the FHBA.

RECOMMENDATION

In summary, staff considers most of the proposed revisions to the Section 19 regulations to be required by the FHBA. Other proposed revisions reflect staff's interpretation of Section 19 in light of the FHBA. Comments received through the rulemaking process will allow the FDIC to consider the views of the industry and other interested parties about the appropriateness and functionality of the proposed changes to the regulations and the FDIC's application procedures under Section 19. For these reasons, staff recommends approval of the attached Notice of Proposed Rulemaking and its publication in the *Federal Register*.

<u>Staff Contacts</u>

Division of RMS:	Tim Schuett Senior Review Examiner (763) 614-9473
Legal Division:	Graham N. Rehrig Counsel (703) 314-3401
	Andrew Lubash Attorney (202) 922-9974

[10] *See* 12 U.S.C. § 1829(f).
[11] 12 U.S.C. § 1829(f)(9).