



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF BANKING
HARRISBURG

THE SECRETARY

April 13, 2005

To the Chief Executive Officers of all Pennsylvania State-chartered Banks, Bank and Trust Companies, Savings Banks, Savings Associations and Credit Unions

Re: Overdraft or "Bounce" Protection Programs

On February 18, 2005, the Federal Deposit Insurance Corporation ("FDIC"), Board of Governors of the Federal Reserve System ("Federal Reserve"), National Credit Union Administration ("NCUA"), and the Office of the Comptroller of the Currency ("OCC") issued the attached Joint Guidance on Overdraft Protection Programs (the "Federal Guidance").¹

This letter and the Federal Guidance are intended to provide guidance to all Pennsylvania state-chartered banks, bank and trust companies, savings banks, savings associations and credit unions regarding the offering of overdraft or "bounce" protection programs to customers. Please be advised that this letter and the attached Federal Guidance replace the letter and its attachment issued to you on the same subject under my signature dated September 30, 2003.

Almost all depository institutions maintain an overdraft program of some type. In general, these types of overdraft programs are either (i) traditional long-standing discretionary programs with an institution's payment or non-payment of occasional overdrafts, and with the institution assessing or waiving its normal fees applicable to the overdrafts or (ii) an overdraft protection program linked to a line of credit product. In recent years, depository institutions have become more active in marketing overdraft protection programs to consumers. The Federal Guidance was issued in response to this growing trend.

The Federal Guidance contains three primary sections: Safety and Soundness Considerations; Legal Risks; and Best Practices. The safety and soundness discussion seeks to ensure that institutions offering overdraft protection programs adopt adequate policies and procedures to address credit, operational, and other associated risks.

The legal risks discussion alerts institutions of the need to comply with all applicable federal and state laws, and advises institutions to have their overdraft protection programs reviewed by legal counsel to ensure overall compliance prior to implementation. Several federal consumer compliance laws that may be applicable to overdraft protection programs are outlined in this

¹ The Office of Thrift Supervision ("OTS") issued separate guidance regarding overdraft protection programs on February 18, 2005, which is applicable only to federal savings associations. For purposes of uniformity, the Department has determined that all Pennsylvania state-chartered institutions should follow the Federal Guidance.

section, including the Federal Trade Commission Act Advertising Rules;² the Truth in Lending Act (“TILA”) and Regulation Z (“Reg Z”);³ the Equal Credit Opportunity Act and Regulation B;⁴ the Truth in Savings Act;⁵ and the Electronic Fund Transfer Act and Regulation E.⁶

The best practices section addresses the marketing and communications that accompany the offering of overdraft protection programs as well as the disclosure and operation of these programs. Some of these best practices include: avoiding the promotion of poor account management; providing a clear explanation of the discretionary nature of the overdraft protection program; clearly disclosing fees; explaining the impact of transaction clearing policies on the overdraft fees consumers may incur, such as in ATM transactions; and monitoring program usage. The Federal Guidance also advises institutions to distinguish overdraft protection services from “free” account features, to prominently distinguish balances from overdraft protection funds availability, and to alert consumers before a transaction triggers any fees.

According to the federal guidance, when overdrafts are paid, credit is extended. By its terms and pursuant to this letter, the safety and soundness part of the Federal Guidance applies to all overdrafts, regardless of whether your institution offers occasional overdraft coverage as an accommodation, or whether your institution employs an overdraft protection program that is specifically designed as a line of credit product.

To the extent that your institution employs overdraft protection programs that are specifically designed as line of credit products, the following lending authorities are applicable to the conduct of such programs in addition to those laws and regulations addressed in the Federal Guidance’s legal risks section. Please note that TILA/Reg Z may apply to such programs, depending on the terms of any written agreement between the institution and the customer.⁷

*Banks, Bank and Trust Companies, and Savings Banks*⁸

Section 322(d) of Pennsylvania’s Banking Code of 1965 (“Section 322”) governs overdraft protection programs for state-chartered banks, stating that banks and bank and trust companies may extend credit on the basis of a written agreement and that:

[a]n agreement shall have the form and contents required by Truth in Lending and shall, in addition, provide if applicable:

² 15 U.S.C. § 45, as enforced by the FDIC, Federal Reserve, OCC, and OTS pursuant to 12 U.S.C. § 1818 and the NCUA pursuant to regulations at 12 C.F.R. § 740.2.

³ 15 U.S.C. § 1601 *et seq.*, and 12 C.F.R. Part 226, respectively.

⁴ 15 U.S.C. § 1691 *et seq.*, and 12 C.F.R. Part 202, respectively.

⁵ 12 U.S.C. § 4301 *et seq.* The Truth in Savings Act is implemented by Regulation DD at 12 C.F.R. Part 230 for banks and savings associations, and the NCUA’s regulations at 12 C.F.R. Part 707 for credit unions.

⁶ 15 U.S.C. § 1693 *et seq.*, and 12 C.F.R. Part 205, respectively.

⁷ It is noted that the payment and imposition of overdraft charges previously agreed to in writing may be considered “finance charges” within the meaning of that term in Reg Z, depending on the program agreement. See 12 C.F.R. § 226.4(c)(3) and Official Staff Interpretation to 12 C.F.R. § 226.4(c)(3) at 12 C.F.R. Part 226, Supplement I.

⁸ Subject to the Department’s non-objection, Pennsylvania state-chartered banks, bank and trust companies, and savings banks may avail themselves of the parity authority contained in Section 201(c) of the Banking Code of 1965, 7 P.S. § 201(c), in order to conduct their overdraft protection programs on the terms applicable to national banks, federal savings associations, or other insured state banks as approved by the FDIC.

* * *

(v) charges which may be imposed in addition to interest, in such amounts as the agreement provides, or as established in the manner the agreement provides, such as . . . *check charges and maintenance charges related to extensions of credit pursuant to overdraft check plans*

7 P.S. § 322(d)(v) (emphasis added). Similarly, Section 506 of the Banking Code of 1965 (“Section 506”) states that savings banks may:

(vii) *make overdraft loans* specifically related to deposits which are subject to withdrawal by check or negotiable order of withdrawal;

* * *

(ix) *in any loan or extension of credit made under the authority of this section*, charge or impose any rate or charge which could be imposed by a bank in connection with any such loan or extension of credit, make agreements in the same manner and with the same terms, provisions and conditions as a bank and, in addition to the restrictions of this section, *shall be subject only to the same disclosure and other requirements, restrictions and limitations imposed upon a bank in connection with such loan or extension of credit.*

7 P.S. § 506(a)(vii) and (ix) (emphasis added). Thus, it is clearly contemplated that savings banks may engage in overdraft protection programs that are specifically designed as line of credit products and that such programs are to be offered on the same terms as are applicable to banks, which would be those terms in Section 322.

Savings Associations

The OTS permits federal savings associations to offer overdraft protection programs to customers, pursuant to 12 U.S.C. § 1464(c)(1)(A) and 12 C.F.R. § 560.30. It is the Department’s position that savings associations may offer overdraft protection programs in the same manner and under the same restrictions applicable to federal savings associations pursuant to OTS regulations at 12 C.F.R. § 560.30, under the authority contained in Section 701(a)(22) of the Savings Association Code of 1967, 7 P.S. § 6020-101(a)(22).

Credit Unions

The NCUA permits federal credit unions to offer overdraft protection programs to customers. Specifically, NCUA regulations state that:

[c]onsistent with policies established by the board of directors, the credit committee or loan officer shall ensure that a credit application is kept on file for each borrower supporting the decision to make a loan or establish a line of credit. A credit union may advance money to a member to cover an account deficit without having a credit

application from the borrower on file if the credit union has a written overdraft policy. The policy must: set a cap on the total dollar amount of all overdrafts the credit union will honor consistent with the credit union's ability to absorb losses; establish a time limit not to exceed forty-five calendar days for a member either to deposit funds or obtain an approved loan from the credit union to cover each overdraft; limit the dollar amount of overdrafts the credit union will honor per member; and establish the fee and interest rate, if any, the credit union will charge members for honoring overdrafts.

12 C.F.R. § 701.21(c)(3). It is the Department's position that credit unions may offer overdraft protection programs in the same manner and under the same restrictions applicable to federal credit unions pursuant to NCUA regulations at 12 C.F.R. § 701.21(c)(3), under the authority contained in Section 501(e)(1) of the Credit Union Code, 17 Pa.C.S. § 501(e)(1). This constitutes a granting of "prior approval" by the Department such that a credit union is not required to file a parity notice pursuant to Section 501(f) of the Credit Union Code, 17 Pa.C.S. § 501(f), in order to offer overdraft protection programs.

The Department's Examination Focus Regarding Overdraft Protection Programs

The Department's examination focus regarding overdraft protection programs will be to assess the risks an institution has accepted by offering an overdraft protection program to its customers, as well as compliance with applicable law and the Federal Guidance. In order to do so, examiners will review any documents describing the program, the manner in which the program is administered and whether the program is conducted according to the best practices outlined in the Federal Guidance, any complaints received, disposition of such complaints, and the extent to which the institution has prepared for the risk by incorporating applicable provisions into the institution's credit and liquidity funds management policies. Any deficiencies will be summarized in the Report of Examination and reflected in the appropriate CAMELS component(s).

If you have any questions regarding this letter, please call James A. Acri, Administrator (Savings Banks) at (717) 787-7333, Donna J. Metcalfe, Administrator (Credit Unions) at (717) 787-7333, or Leonard C. Bayich, Administrator (Banks) at (717) 783-2253 or contact the Department via the Department's website at www.banking.state.pa.us.

Sincerely,



A. William Schenck III
Secretary of Banking

Attachment