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Overdraft Programs: Understanding the Risks

Even though the law on overdraft programs has not recently changed, financial institutions are currently facing significant risks associated with their overdraft programs, including class action lawsuits being filed or threatened against them and possible unfair or deceptive practice violations by examiners. The main issues raised in the lawsuits and by examiners are highlighted below, and financial institutions should be aware of these potential risks and take appropriate action to mitigate them.

Overdraft fees

One common issue raised in these lawsuits is that financial institutions did not adequately disclose when a consumer would be charged overdraft fees. These lawsuits allege that the financial institutions did not sufficiently disclose whether they use an available balance or actual balance to determine if account is overdrawn, when customers or members will incur overdraft fees, and how the balance the financial institutions uses impacts whether overdraft fees will be charged.

Multiple Non-Sufficient Funds Fees

Another issue raised in these lawsuits is that financial institutions did not properly disclose to their customers or members that they would be charged non-sufficient funds fees each time an item is presented for payment and returned for non-sufficient funds. For example, if one check was presented for payment twice and returned twice, financial institutions did not disclose to their customers that they would be charged non-sufficient funds fees each time the check was returned, resulting in two non-sufficient funds fees to the customer.

Preauthorization Holds and Transaction Processing

Another potential risk for overdrafts occurred when financial institutions that use an available balance method assessed more overdraft fees than deemed appropriate when a point of sale transaction was authorized based on an available balance at the time of the authorization but later settles against a negative available balance. For example, if a consumer had a balance of $40 and initiated a $30 point of sale transaction, that transaction was authorized against a positive available balance. If the consumer makes a subsequent transaction of $20, the available balance became negative $10. If the first transaction posted after the second transaction posted and the financial institution assessed overdraft fees at the time of posting, then both transactions would be assessed overdraft fees even though the first transaction was authorized with a positive available balance at the time of the transaction. This was addressed in the FDIC’s June 2019 Supervisory Highlights. The FDIC examiners noted that this practice could potentially be unfair or deceptive when a financial institution uses an available balance method and assessed more overdraft fees than were appropriate based on actual spending or when its practices were not sufficiently disclosed.

The examiners noted the following measures that financial institutions could enact to mitigate these risks:

- Providing clear and conspicuous disclosures regarding when an overdraft fee may occur in connection with the use of the available balance method.
- Ensuring that overdraft fees are not changed when a transaction was authorized with a positive available balance but later settles against a negative available balance, when a financial institution uses the available balance method.

Time for Action
While some guidance from regulators or Congress on the subject would be helpful for financial institutions, it is unclear if such guidance will come. However, recently there has been proposed legislation introduced that would place restrictions on the overdraft services offered by financial institutions in an effort to prohibit financial institutions from engaging in unfair and deceptive actions, including limiting the number of overdraft fees charged per account each month and year, ensuring fees are reasonable and proportionate to the amount of overdraft, and restricting when a financial institution can charge non-sufficient funds fees.

Financial institutions should review the policies and procedures of their overdraft programs based on the risks associated with the allegations made in these lawsuits and issues raised by examiners, including reviewing their disclosures to ensure they are sufficiently disclosing how and when overdraft and non-sufficient funds fees are assessed.

[1] Federal Deposit Insurance Corporation Consumer Compliance Supervisory Highlights June 2019.
[2] Overdraft Protection Act of 2019, 2019 Cong US H.R. 4254

SECURE ACT 2019 Attached to Year-End Spending Bill

With the Setting Every Community Up for Retirement Enhancement (SECURE Act) of 2019 passing the House of Representatives by an almost unanimous vote in May. Since then, the bill has been in the Senate until late Monday, December 16, 2019 when it was attached to a bipartisan appropriation bill aiming to avoid a government shutdown.

Below are some of the key components and potential changes that would impact individual retirement accounts:

FUNDING FLEXIBILITY
A major change that would impact IRA owners would be the ability to contribute to Traditional IRAs past the age of 70 ½ if they have earned income. With many people staying in the work force longer, this would allow for people to still fund their IRA longer.

RMDS AND BENEFICIARY OPTIONS
The SECURE Act would extend the required age to take required minimum distributions from 70 ½ to 72. Owners who obtained the age of 70 ½ before December 31, 2019 would still be required to begin taking RMDs in 2020.

The Act also provides that most non-spouse beneficiaries would be required to withdraw the entirety of their share of an inherited IRA within 10 years, which removes the option of spreading distributions over a life expectancy.

CHILDBIRTH AND ADOPTION
Under the SECURE Act, owners would be able to take a penalty-free withdrawal of up to $5,000 for childbirth or adoption expenses. An IRA owner would be eligible to repay the funds back into the IRA.

WHAT THIS MEANS FOR FINANCIAL INSTITUTIONS
If this passes, Compliance Systems will be making changes to our solution to reflect these changes. Financial institutions may have to send amendments to existing plan owners and start using the updated documents when creating new plans. As we have in the past, Compliance Systems will provide surgical amendments for financial institutions to send to their IRA plan owners.

Avoid the MIRE of Force-Placed Flood Insurance Premiums

The National Flood Insurance Act of 1968 (the “Act”) states that financial institutions are prohibited from making, increasing, renewing, or extending ("MIRE") any loan secured by a building or mobile home located in a special flood hazard area (a "Designated Loan") unless such building or mobile home (and any personal property securing the Designated Loan located within same) is covered by flood insurance for the term of the Designated Loan, for an amount at least equal to the lesser of (a) the outstanding principal balance of the Designated Loan or (b) the maximum limit of coverage available for the particular type of property under the Act [1].

What happens when it is discovered that the flood insurance policy has either been cancelled, terminated, or is otherwise for an insufficient amount to satisfy the requirements under the Act? First, the financial institution must notify the borrower that they must obtain, at their expense, flood insurance at least equal to the amount required under the Act [2]. If the borrower fails to obtain adequate flood insurance within 45 days after such notification, then (a) the financial institution is required to purchase flood insurance on the borrower's behalf; and (b) the financial institution may charge the borrower for the cost of premiums and fees incurred in purchasing the force-placed insurance policy [3].

In a letter from the American Bankers Association (the "ABA") to the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC") dated April 22, 2016 (the "ABA Letter"), the ABA requested some clarification as to whether advancing the premiums and fees for force-placed flood insurance to a Designated Loan would constitute a MIRE event, which triggers certain requirements and actions under the various federal flood insurance statutes and regulations. According to the ABA Letter, examiners from the above referenced agencies had started to take the position that adding such force-placed flood insurance premiums and costs to the balance of the Designated Loan would constitute a MIRE event.

The Board, FDIC, and the OCC (the "Agencies") responded to the ABA Letter on May 22, 2017 (the "Agency Letter") and offered the following guidance on how a financial institution can recover the premiums and costs incurred for force-placed flood insurance without triggering a MIRE event: their options are to either add the force-placed insurance premiums and fees in a separate, unsecured account, bill the borrower directly for the cost of the force-placed flood insurance, or add the premiums and fees to the balance of the Designated Loan. The Agency Letter also states that adding the force-placed flood insurance premiums and fees to the Designated Loan balance will not constitute a MIRE event the if the Designated Loan documents include a provision permitting the financial institution to pay for the force-placed flood insurance premiums and costs on behalf of the borrower and then to add such amounts advanced on behalf of the borrower to the balance of the Designated Loan.

It should also be noted that if the financial institution adds the force-placed flood insurance premiums and costs to the balance of the Designated Loan, the financial institution should make sure that the force-placed flood insurance amount is sufficient under the Act to account for the increased balance of the Designated Loan.

Given the stance detailed in the Agency Letter, financial institutions should review their loan documents to confirm the existence of provisions that allow for the financial institution to add any premiums and costs related to force-placed flood insurance to the underlying loan to avoid the occurrence of a MIRE event.

[1] 42 U.S.C. §4012a(b)(1)(A); 12 CFR 22.3(a); 12 CFR 208.25(c)(1); 12 CFR 339.3(a).
[2] 12 CFR 22.7(a); 12 CFR 208.25(g)(1); 12 CFR 339.7(a).
[3] Id.

HMDA On My Mind

One of the hot topics for 2019 was the Home Mortgage Disclosure Act ("HMDA"). In fact, this has been an ongoing topic of discussion for many years. Almost one year ago exactly, the Bureau of Consumer Financial Protection ("CFPB") launched a beta version of its HMDA reporting platform and issued its final policy guidance describing how it planned to modify loan-level data reported under HMDA before its disclosure to the public.

Despite releasing final policy guidance in late 2018, new HMDA discussions resumed in early 2019.

In early 2019, the Office of the Comptroller of the Currency ("OCC") issued Bulletin 2019-12, which provided key data fields for full and partial HMDA reporters. This Bulletin rescinded 2017 guidance on the same topic. Of the 110 HMDA data fields, the OCC identified 37 key fields that it would typically use to test and validate compliance. However, only 21 of these fields will typically be validated for institutions qualifying for a partial exemption.

There was also a flurry of activity providing additional instruction and examination transparency. In April 2019, the OCC published the interagency examination procedures. The published procedures incorporate transaction testing guidelines transmitted to examiners in accordance with Bulletin 2017-31. Then mid-summer, the CFPB published the Filing Instructions Guide for data collected in 2019. While the 2019 Guide was published with the year half over, it seems the CFPB has been quicker in its turnaround for 2020.

Just three months after publishing the 2019 Guide, the 2020 Filing Instructions Guide was released. The 2020 Guide identifies a change right up-front; beginning in 2020 covered institutions reporting a combined total of at least 60,000 applications and covered loans in the preceding year are required to report quarterly. The OCC has published a supplementary guide for those institutions meeting this threshold.

In the 2015 HMDA Rule, the CFPB established an institution and transaction threshold dictating whether institutions must report under HMDA. The 2015 Rule set the reporting threshold for open-end lines of credit at 100 loans in the preceding two calendar years. Prior to its effective date, the reporting threshold was temporarily increased from 100 to 500 loans for calendar years 2018 and 2019. This threshold will remain in place at least through January 1, 2022.

As our summer ended, the Federal Financial Institutions Examination Council ("FFIEC") announced the availability of HMDA peer data for 2018. The data was comprised of more than 5,600 mortgage lending transactions and included a total of 48 pieces of data, some of which was reported for the first time in 2018. The HMDA data is the most comprehensive publicly available information on mortgage market activity allowing the public to assess how financial institutions are serving the housing needs of their communities, and facilitating federal financial regulators' fair lending, consumer compliance and Community Reinvestment Act examinations.

There are a number of takeaways from the HMDA activity in 2019. HMDA appears several times in the CFPB's Fall Rulemaking Agenda published last month. In 2020, we can expect a final rule to be issued on the reporting thresholds. When the CFPB extended the temporary reporting threshold, it simultaneously proposed setting the permanent reporting threshold at 200 open-end lines of credit. The comment period was extended until October 15, 2019 and we can expect a final rule to be issued on the topic in 2020.

While there has been no new activity related to the guidance issued last December on the public dissemination plan for HMDA data, the topic once again appears on the CFPB's agenda. In its 2015 Rule, the Bureau adopted a balancing test to use to determine whether and how HMDA data should be modified prior to its public disclosure. The CFPB sought guidance in 2017 on this topic and issued its final guidance last December. However, after consideration of comments expressing concerns about disclosing loan-level HMDA data publicly, the CFPB has placed this subject on its radar once again; a new notice and comment rule making will be forthcoming in 2020 with the goal of enabling the CFPB to adopt a more definitive approach to public disclosure of HMDA data in future years.

Finally, advanced notice of public rulemaking was issued in May seeking information on whether changes should be made to certain datapoints or revisions to require additional data. At that time, the CFPB also sought comment on extending the HMDA reporting requirements to certain commercial transactions. As we head into 2020, we can expect to hear more on this topic as it is listed in the proposed rule stage on the CFPB's agenda.

Bulletin 2019-12 | Bulletin 2019-19 Including Interagency Examination Procedures

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2019 Filing Instructions Guide, 2020 Filing Instructions Guide, and Quarterly Filer Supplemental Guide
Threshold Extension | FFIEC August Publication
Unified Agenda | May ANPRM

The Continued Sage: An End-of-Year Recap of Marijuana Banking

This is a companion piece to the CSinsider newsletter titled Recent Developments Affecting Banking and Marijuana-Related Businesses.

Where We Left Off
As of June 2019, the hopes of marijuana-related businesses (MRBs) and the financial institutions wishing to serve them remained high. In addition to an increase in the number of states that have legalized medicinal and/or recreational use of marijuana and the growing support from the private sector, there were also pending initiatives on the national political and legislative scene which sought to provide clarity to the industry. Many of these initiatives took the form of the Strengthening the Tenth Amendment Through Entrusting States (STATES) Act and the Secure And Fair Enforcement (SAFE) Banking Act.

The STATES Act Then
The STATES Act seeks to empower each state to determine whether marijuana should be legalized, decriminalized, or prohibited altogether without federal oversight. At the time of the prior article, the STATES Act was referred to the Senate Judiciary Committee.

The STATES Act Now
After being referred to the Senate Judiciary Committee, the legislation was also referred to the Committees of Energy and Commerce and Transportation and Infrastructure, and later to the Subcommittees on Highways and Transit and Crime, Terrorism, and Homeland Security. However, despite this apparent movement, the STATES Act has not made significant progress. Given the current legislative agenda and impending conclusion of the 116th Congress, the future of the STATES Acts is unsure.

The SAFE Banking Act Then
The primary goal of the SAFE Banking Act is to "increase public safety by ensuring access to financial services to cannabis-related legitimate businesses and service providers and reducing the amount of cash at such businesses." To accomplish this, the Act creates a safe harbor for financial institutions that choose to provide services to MRBs, limits the ability of federal regulators to impose sanctions or penalize institutions that engage MRBs, and creates clear compliance requirements for institutions choosing to do business with MRBs. As of the second quarter in 2019, the SAFE Banking Act passed the House Financial Services Committee with significant support (45 yay – 15 nay).

The SAFE Banking Act Now
In contrast to the STATES Act, the SAFE Banking Act has experienced significant movement. On September 25, 2019, the SAFE Banking Act passed the House of Representatives (with 321 yay and 103 nay votes) and moved on to the Senate. While this is good news for MRBs and the financial institutions wishing to serve them, the SAFE Act must still pass the Senate and make it to the Oval Office.

Recent Developments

The MORE Act
While the STATES and SAFE Banking Acts are directed through Congress, some legislators are attempting to address the MRB-Financial Services question by decriminalizing marijuana on the federal level. On November 20, 2019, the Marijuana Opportunity, Reinvestment, and Expungement (MORE) Act passed the House Judiciary Committee with bipartisan support (24 yay to 10 nay). The MORE Act seeks to remove marijuana from the federal Controlled Substances Act. It will also make it easier for physicians to prescribe medicinal marijuana, facilitate Small Business Administration support of MRB entrepreneurs, and provide a means through which individuals who were previously convicted of low-level marijuana violations can move forward

without the stigma of that conviction. While passage of the MORE Act would clear the path for financial institutions and MRBs to form productive and stable relations, the legislation has a long way to go. Compliance Systems will continue to keep you updated on developments.

Reduction in Financial Institutions Servicing MRBs, Private Industry Involvement, and Development of Alternative Solutions

Although the political landscape appears more favorable for those initiatives seeking to provide clarity for financial institutions and MRBs, the fact remains that marijuana is still a “Schedule I” controlled substance and financial institutions that knowingly provide services to MRBs are violating federal law when doing so. Unfortunately for MRBs, the lack of any meaningful progress related to the legality of banking MRBs has had a cooling effect on the financial industry’s tolerance for the risk associated with providing services to MRBs. As a result, there’s been a leveling of the number of banks and a reduction in the total number of credits unions choosing to serve MRBs. While the movement in these numbers (only 10 more banks and 2 fewer credit unions today than before), considering that fewer than 9 percent of banks and 3 percent of credit unions are MRB-friendly, any leveling or decease is concerning for the industry.

The lack of certainty in banking MRBs and the associated inability of MRBs to utilize conventional financial services has required MRBs to seek alternate means to accomplish what is routine for other businesses; how to pay your employees, taxes, rent, utilities, and so on. This need has spurred the innovation of alternative financial services, such as the creation of bank accounts in which MRBs funds are commingled with those of other, non-MRB organizations, the use of debit or credit cards to purchase gift cards which are then used as a sort of voucher used to purchase marijuana and marijuana-related products, and even automated teller machines that dispense chits redeemable for MRB products instead of cash. Although these alternate-financial services offer some respite from the MRB-banking challenges, the viability – if not the legality – of such mechanisms is questionable and likely unsustainable.

What’s Next?

Until the federal government acts to create an avenue for financial institutions to provide services to MRBs (e.g., the SAFE Banking Act), amend the federal code related to marijuana’s status as a controlled substance (e.g., the MORE Act), or provide legally authoritative guidance as to how financial institutions can remain in compliance when serving MRBs. MRBs, are relegated to using alternative financial services like those described above, and/or rely on the small number of financial institutions choosing to provide services to MRBs. In all events, what’s next for MRBs and financial institutions is unclear.

Compliance Systems News

Compliance Systems will be closed on December 24, 25, and January 1st. If you are in need of assistance during those three days, visit the Community Lounge. Your answers may be there!

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