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

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[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.

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