

# Overdraft Class Action Lawsuits

## What Credit Unions Need to Know

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An **AuditLink** Whitepaper



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# Scope of the Overdraft Risk

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**Overdraft fees have caused dozens of financial institutions, including some credit unions, to be targeted in significant class action litigation. Furthermore, credit unions may also be targeted for governmental fines and regulation regarding when and how overdraft fees are charged.**

Overdraft fees are targets of both class action lawsuits and governmental action against financial institutions. The settlement and award amounts are nearing one billion dollars for financial institutions who engaged in [high to low debit card transaction processing](#)<sup>1</sup>. Just recently, a credit union in California settled a class action lawsuit where the institution was accused of [invalidly charging overdrafts on actual balance](#)<sup>2</sup> while advising members that overdrafts would be charged on available balances. Recently the Consumer Finance Protection Bureau (“CFPB”) has gone ahead and [demanded data from Fiserv and FIS](#)<sup>3</sup> regarding the fee collection process from their financial institution clients, presumably as a prelude to enforcement actions against financial institutions. The threat of class action lawsuits or governmental action is very real, and credit unions should *immediately* review both how overdraft fees are assessed and how members are notified.

Please note that most credit unions are not bad actors in the overdraft assessment world, and in fact a credit union’s fair and open method of assessing overdrafts can provide a competitive advantage in the marketplace. A credit union can protect itself from large damage awards by carefully ensuring that its disclosures and information in its membership agreement matches its actual practices, and that overdraft consumer opt-in and opt-out preferences are strictly adhered to.

**CU\*Answers does not provide legal advice to clients and cannot provide an opinion as to whether the risk identified here applies to your institution in the jurisdiction(s) where your credit union does business. If you have concerns whether you are at risk of an overdraft fee class action lawsuit or governmental regulation, CU\*Answers recommends you provide your own legal counsel with information regarding your current overdraft fee practices, the disclosures you provide to your members, and this document.**

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<sup>1</sup> Case Center, “Bank Overdraft Fees Litigation.” *Lieffcabraser*. Accessed May 27, 2015. <http://www.lieffcabraser.com/Case-Center/Bank-Overdraft-Fees-Litigation.shtml>

<sup>2</sup> “Notice of Proposed Action and Class Action Settlement.” *KCCLC*. Accessed May 27, 2015. [http://classaction.kccllc.net/Documents/OCU0001/OCU\\_NOT\\_web.pdf](http://classaction.kccllc.net/Documents/OCU0001/OCU_NOT_web.pdf)

<sup>3</sup> Urico, Roy. “CFPB to Fiserv: Hand Over Overdraft Data.” *Credit Union Times*. May 17, 2015. Accessed May 27, 2015. [http://www.cutimes.com/2015/05/17/cfpb-to-fiserv-hand-over-overdraft-data?eNL=55567d59150ba0f55b8b459f&utm\\_source=Daily&utm\\_medium=eNL&utm\\_campaign=CUT\\_eNLs&LID=15770488&page=1](http://www.cutimes.com/2015/05/17/cfpb-to-fiserv-hand-over-overdraft-data?eNL=55567d59150ba0f55b8b459f&utm_source=Daily&utm_medium=eNL&utm_campaign=CUT_eNLs&LID=15770488&page=1)

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# Overdrafts in the News

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Ever since the massive \$200+ million damage award to consumers of Wells Fargo, there have been multiple class action lawsuits filed against dozens of financial institutions for high to low debit card transaction processing. Damage awards and settlements have been extremely high, with Bank of America alone paying out \$410 million in a settlement. In addition, the news media has generally put very negative publicity on this practice, which has further spurred governmental regulation with respect to opt-in and opt-out of overdraft protection.

With high-to-low debit card processing class actions winding down, a new set of class actions have appeared, specifically targeting credit unions in California. More than one law firm has sued credit unions on behalf of members alleging that the credit unions have assessed overdraft fees on “available balance” in violation of the membership agreement and/or the credit union’s disclosures. There has already been a \$1.8 million settlement in this litigation.

Furthermore, in 2015 the CFPB engaged in its first enforcement action regarding overdraft practices, by fining Alabama based Regions Bank \$7.5 million for failure to adhere to overdraft opt-in and opt-out regulation. The CFPB’s demand for overdraft information from Fiserv and FIS almost certainly will result in additional enforcement actions against financial institutions that have violated overdraft opt-in and opt-out regulations.

Credit unions should not assume that they are immune from either CFPB action or class action litigation based on size. While it is true that the majority of lawsuits have focused on larger institutions, there is still the danger that improperly gathered fees over a long period of time might be enough for a law firm to consider a lawsuit settlement to be worth the cost of the class action litigation.

## **Big Banks have been Gaming Your Overdraft Fees to Charge You More Money**

*“There was little transparency in reordering until a series of consumer lawsuits against banks for wrongful overdraft charges four years ago brought the practice to light. Those cases led to some substantial changes in the ways banks handled overdraft charges, as did federal regulations in 2010, which forced banks to ask consumers to opt into overdraft services.”*  
<http://www.washingtonpost.com/blogs/wonkblog/wp/2014/07/17/wells-fargo-to-make-changes-to-protect-customers-from-overdraft-fees/>

## **Class-Action Lawsuits Target CU Overdraft Programs**

*“CUNA Mutual reports that it is aware of four credit unions in California that have been hit with the lawsuits regarding their overdraft practices, noting that the lawsuits are not all coming from one legal firm. According to CUNA Mutual, the lawsuits against the credit unions allege that the fees are being improperly assessed on the available balance instead of the actual balance, the CU’s fee structure has not been clearly communicated, and that members are not being provided with accurate available balance information.”*  
<http://www.cutoday.info/THE-feature/Class-Action-Lawsuits-Target-CU-Overdraft-Programs>

## **CFPB Fines Regions Bank \$7.5 Million for Unlawful Overdraft Practices**

*“Today the CFPB is taking its first enforcement action under the rules that protect consumers against illegal overdraft fees by their banks,” said CFPB Director Richard Cordray. ‘Regions Bank failed to ask consumers if they wanted overdraft service before charging them fees. In the end, hundreds of thousands of consumers paid at least \$49 million in illegal charges. We take the issue of overdraft fees very seriously and will be vigilant about making sure that consumers receive the protections they deserve.’”*  
<http://www.consumerfinance.gov/newsroom/cfpb-fines-regions-bank-7-5-million-for-unlawful-overdraft-practices>

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# Overdraft Examples Resulting in Litigation

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## Example of High to Low Overdrafts

*A member spends \$10, \$20, \$50 and \$100 (in that order) in four transactions but only has \$140 in the account.*

*If the member's transactions are processed **low to high**, the member will only be charged a **single overdraft fee**, when the \$100 is processed.*

*The same is true if processed **in transactional order**, as the member's transactions will go into overdraft when the \$100 is processed.*

*However, if processed **high to low**, the member will have an overdraft fee when the \$50 transaction is processed, and then again when the \$20 transaction is processed, and finally once more when the \$10 transaction is processed. This is a total of **three overdraft fees**.*

There may be good reasons why the member might *want* the transactions processed high to low, if the high payment was for mortgage or rent, or a car payment. Some of the question will be whether the member clearly understands that this is what will happen if the member has high to low processing.

## Failure to Adhere to Opt-Out

*By law, overdraft protection programs are optional. Failure by a financial institution to offer opt-out or adhere to consumer wishes with respect to overdraft protection is grounds for regulatory action.*

The CFPB has fined one financial institution for failure to ask consumers to opt-out of overdraft protection, per federal regulations. In addition to the fines, the bank refunded all consumers, and hire an independent consultant to identify all remaining consumers who were charged the illegal fees. In addition, the bank was required to identify and fix all instances of negative credit reporting resulting from the unlawful fees.

## Example of “Available Balance” Overdrafts

*A member who has \$100 in actual balance and has \$70 tied up in debit card authorizations and check holds. The member looks at actual balance and sees \$100, and so makes a \$35 purchase. Unfortunately, the **available** balance is only \$30. If the financial institution either told the member that overdrafts would only be charged on actual balance, or did not make it clear that the member could be charged for exceeding the available balance, the financial institution could be in violation of consumer protection laws.*

**Actual balance** is the amount of money a member has in an account **at any one time**. The actual balance reflects transactions that have posted to the account, but not authorized pending transactions. **Available balance** is the amount of money in the account **available to use** without incurring an overdraft fee.

The issue is where there are contractual provisions that allow for courtesy pay or overdraft fees to be assessed when there was a negative actual balance in the checking account, **but the financial institution instead charged courtesy pay or overdraft fees based on the available balance**. It could also be considered an unfair practice if there was a positive balance in the member's checking account that was sufficient to cover the transaction that resulted in the fee being imposed.

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# Key Litigation Concepts

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## High to Low Debit Card Overdrafts

There are three key legal areas:

**Is there, in fact, transaction re-ordering?** This is the practice of processing a customer's largest transactions, including bill payments, ATM withdrawals, debit card transactions, and check processing, in order of the largest amounts rather than in chronological order. Whether or not this practice is *unfair* appears to depend on a subjective and objective test:

**Are marketing materials misleading?** Are financial institutions providing misleading or incomplete marketing materials describing their overdraft fees? This includes consumer communications and membership agreements. (subjective)

**Unfair impact on low-income and young members:** Do low-income and younger bank customers unfairly incur overdraft fees more often than other customer groups? (objective)

## Available Balance Overdrafts

There are two core legal areas here:

**Are members charged overdrafts on actual or available balance?** Depending on whether this practice is *unfair* depends on a test that is part objective, and part subjective:

**Does the membership agreement conflict with the actual practice, or in practice is it difficult for a consumer to understand when the balance will be overdrawn?** A financial institution will be in serious trouble if it collects overdraft fees in violation of its agreements with consumers or in its disclosures. But it also appears that a financial institution could face significant risk if collects fees on available balance but only displays actual balance on online banking, for example.

## Sample from the Bank of America Litigation

*In addition, the Bank misleads its customers regarding its reordering practices. Instead of unequivocally telling its customers that it will reorder debits from highest to lowest, the Bank instead states in its contract that "We may determine in our discretion the order of processing ... in any order at our option." This statement is deceptive because it is, in fact, the practice of the Bank to always reorder debit from highest to lowest.*

*The Bank's policies have a disproportionate impact on low-income customers. Almost by definition, these fees disproportionately affect the poor, who are most likely to maintain low balances. Moebs Services, a research company that has conducted studies for the government as well as banks, estimates that 90 percent of overdraft fees are paid by the poorest 10 percent of banks' customer base. Moreover, these fees have the tendency to create a domino effect, because the imposition of a service charge on an account with a negative balance will make it less likely that the account holder's balance will reach positive territory, resulting in more fees. [emphasis added]*

## Sample from the OCCU Litigation

*[Plaintiff] claims that she and all other Class Members were subject to contract provisions with Orange County's Credit Union ("OCCU") that only allowed courtesy pay or overdraft fees to be assessed when there was a negative actual balance in the checking account. [Plaintiff] further claims that OCCU's practice was to charge courtesy pay or overdraft fees based on the "available balance" instead of the actual balance, which resulted in courtesy pay or overdraft fees being assessed against [Plaintiff] and other members when there was a positive actual balance in the account. [Plaintiff] claims this was in violation of OCCU's disclosures and account agreements. [emphasis added]*

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# Credit Union Mitigation Steps

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## CU\*Answers does Debit Card Processing in Order Received

Credit unions on the CU\*BASE platform have debit card transactions processed in the order they are received. It is not possible for a credit union to modify this processing, and therefore credit unions cannot be sued for high to low debit card transaction processing.

## Check Processing is determined by the Credit Union

While high to low check processing is legal in most jurisdictions, credit unions can confirm if they wish to continue the practice by going into CU\*BASE menu option **MNCNFA #16 Member SD/Checking Configuration**. Credit unions can review the order of share draft clearing (ascending/descending amount)

## Review Overdraft Protection Configurations

Another menu option is **MNCNFA #9 NSF/OD Configuration**. A credit union can review fees charged, which balance the fee is based upon, fee tolerances, the fee itself relative to safe harbor amount, and all overdraft protection configurations.

## Review Share Product Configurations

ANR (Courtesy Pay) settings can be reviewed on **MNCNFA #1 Share Product Configuration**. A credit union should review ANR settings on conditions for granting activation of ANR limit.

## Review Opt In/Opt Out Configurations

Credit unions need to be careful of Opt Out preferences, which can be found in **MNCNFC #25 Define Workflow Controls**.

## Review Membership Agreement

Be sure that the process of the credit union for overdraft fees matches what is found in the Membership Agreement. It could be considered deceptive and unfair if the Membership Agreement or other disclosures are silent on how fees are collected, or if the credit union's practices do not match what the Agreement states.

## Review Fee Disclosures

Ensure all marketing with respect to overdraft fees is consistent and accurate with credit union practices. From a disclosure perspective the credit union can add either information or a link to a separate URL using the **Internet Member Services Configuration Screen MNCNFE #1**. Choose the first option from the list and update the instructions next to the Regulation E section. The credit union needs to understand the disclosure requirements for both an in person request and a remote request.

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## Additional Resources

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The PEW Trust has a model disclosure box to help credit unions with disclosures.

<http://www.pewtrusts.org/en/multimedia/data-visualizations/2011/long-on-words-short-on-protections--the-need-for-a-disclosure-box>

The CFPB has a consumer advisory on overdrafts.

[http://files.consumerfinance.gov/f/201504\\_cfpb\\_consumer-advisory\\_overdraft.pdf](http://files.consumerfinance.gov/f/201504_cfpb_consumer-advisory_overdraft.pdf)

The FDIC has guidance on automated overdraft programs.

<https://www.fdic.gov/news/news/financial/2010/fil10081.html>

Meobs Services also has guidance on overdraft programs.

<http://www.moebs.com/BestPractices.aspx>

## Still Worried? We Can Help!

**AuditLink offers a service to review your overdraft programs and assist with configuring CU\*BASE. We will help reduce your risk by examining your overdraft configurations and reviewing your membership agreement and disclosures. We can also assist with calculating income changes based on revisions to your overdraft policies and procedures.**

**AuditLink**  
CU\*ANSWERS Management Services