Template For Evaluating Transaction Risk

Addressing Recent Law Suits Associated With Overdraft Protection Processing

Presented by AuditLink CU*ANSWERS Management Services
Information compiled May, 2012

This document was designed to assist credit unions with evaluating the risk associated with posting transactions to member accounts, specifically as it pertains to the effect the posting order has on overdraft and NSF fees. Class action lawsuits have been filed in a number of states relative to perceived "non-consumer-friendly" transaction posting practices, and both banks and credit unions are either settling or losing many of them. What is becoming apparent is not the fact that the credit union posted high to low, as an example, but the fact that they did not disclose to the customer the posting order and its effect on potential fees. Other cases that have recently been settled have actually accused the financial institution of manipulating the posting order on existing accounts for the sole purpose of increasing revenue.

To address and review this risk, CU*Answers has formulated the following template for you to use to complete your vendor research and report on transactional risk to your Board of Directors, as an exercise to control any potential financial risk associated with these posting processes.

The document is broken down into three sections. The first is the template itself, which is structured to address each type of transaction that can be posted to a member's account, the third party involved, and a description of the CU*BASE posting sequence. When complete, this template would serve as the credit union's transactional risk assessment and report to the Board of Directors.

The second section of the document (see Appendix A) includes a synopsis of recent court cases, to give credit unions additional background related to these types of lawsuits. This review is intended to assist your credit union when evaluating internal processes related to those which have been cited in prior cases.

The final document (see Appendix B) is an edited excerpt of a disclosure originally produced by State Employees Credit Union in North Carolina. This edited disclosure has also been submitted to the CFPB for consideration as they have been working with PEW Research on potential required disclosures for members who can potentially be charged overdraft or courtesy pay fees. CU*Answers would strongly encourage every credit union to review this and consider augmenting your member checking account disclosures or incorporating them into the TIS disclosure. The full disclosure can be found at https://www.ncsecu.org/DepositAccounts/PewSafeChecking.html. Transparency is the goal, and incorporating the sections on how overdrafts can be covered and the order of posting could go a long way toward educating members on how to avoid fees and potentially limiting liability related to these types of lawsuits.

How to Use the Template to Create Your Own Risk Assessment

The template should be completed for each of your existing transactional posting processes, including the description of how CU*BASE or other third parties sequence the transactions prior to posting, and an evaluation of risk associated with the process. The goal is to show that the

Management Team has thoughtfully reviewed each process as it relates to the posting of transactions from the following channels:

- ATM/Debit Card
- ACH
- Checks
- iPay Bill Payment (as this does post as a batch file each day)
- Manual posting of batch night drops

The core system, CU*BASE®, is the traffic cop which completes the posting function, and therefore it is necessary to involve CU*Answers to understand the specific routines relative each channel listed above. However, CU*Answers can only guarantee how transactions are posted once received from the third party. Additional due diligence must be performed to understand any upstream re-sequencing of transactions prior to them being received by CU*Answers.

In April 2012, CU*Answers contacted the following ATM/Debit Card processors:

- STAR
- COOP
- ELAN
- VANTIV
- FIS
- METAVANTE
- SHAZAM
- FISERV
- ONEBRIDGE
- JHA
- MAP

It was confirmed that none of the above vendors currently engage in re-sequencing. All of them process transactions in the order received. However, you should not use CU*Answers as your proxy for doing your due diligence. You should document your own correspondence with your vendors as to their specific posting practices.

Once completed the credit union would print out the following pages along with a summary of the overall risk and any recommendations the Management Team feels appropriate to make to the Board of Directors. If required action is recommended that would affect the processing of any of the posting types listed in the assessment, Management should also give a high level plan on how those changes will take place.

[SAMPLE]

Report to Board of Directors on Potential Transaction Risk

Presented by the Risk Mitigation Committee, June 8th, 2012

In response to lawsuits related to the order in which transactions are posted from batch check, ATM/Debit card, and ACH posting processes, the Management Team of XYZ Credit Union felt it necessary to review the credit union's current posting schema and impact on member fees.

The Management Team has researched the CU*BASE platform and each one of our third party vendors to determine how the order in which transactions are posted affects member overdraft fees. We also evaluated whether or not independent transaction sequencing occurs upstream at third-party vendors.

To date the Management Team has never consciously made a decision to maximize overdraft or courtesy pay fee income by manipulating the order in which third party transactions are posted. XYZ Credit Union does everything possible to educate members on utilization of their transactional accounts to limit their potential overdraft fees, including marketing material for courtesy pay, monthly review of excessive overdraft fee activity by members, and explaining transaction posting practices on member disclosures.

Transaction Posting

This assessment provides a summary of the method CU*BASE uses to post transactions (primarily debits) that are received from an external vendor, specifically as it relates to the order in which these transactions are posted to a member's account. The summary of posting method came directly from CU*Answers. Each third party is then evaluated relative to any upstream re-sequencing which could have a potential impact on member fees. Verifications have been provided by the third party as validation. The final section describes the potential litigation risks associated with this type of posting schema.

[NOTE: CHOOSE THE ATM TYPE (BATCH OR ON-LINE) THAT APPLIES]

Online ATM/Debit Card Transactions

Summary of posting method:	CU*BASE posts transactions as they are received. When an individual online transaction is presented, it is posted. Keep in mind that CU*BASE is at the end of the line for these transactions: VISA/MC presents transactions to the network and then the network presents them to CU*BASE. This applies to interactive transactions occurring at the time members make purchases as well as when posting transactions after a period of stand-in with the network.
Posting order for transactions:	**As presented by vendor**
Verification of Third Party	[As an example:] "We have contacted XXXXXX requesting that they supply us with the posting sequencing process. We have received email verification that they do not sequence these transactions in any way prior to their being sent to our our data processor."
Risk Evaluation	[As an example:] "Based upon our vendor's response we feel the transactional risk is low for this channel as there is no manipulation of the

	transactions prior to posting.”

Batch (Offline) ATM/Debit Card Transactions

Summary of posting method:	The CU*BASE platform was designed the same for all vendors. The batch file received is processed credits first, then debits, sequenced in the order received. Keep in mind that CU*BASE is at the end of the line for the batch of transactions: VISA/MC presents ATM/debit card clearings to the network and then the network presents them to CU*BASE.
Posting order for transactions:	**As presented by vendor**
Verification of Third Party	[As an example:] “We have contacted XXXXXX requesting that they supply us with the posting sequencing process. We have received email verification that they do not sequence these transactions in any way prior to their being sent to our data processor.”
Risk Evaluation	[As an example:] “Based upon our vendor’s response we feel the transactional risk is low for this channel as there is no manipulation of the transactions prior to posting.”

Checks

Summary of posting method:	CU*BASE allows for credit unions to configure how checks should be sorted and posted. The two options available: • Smallest-to-largest OR • Largest-to-smallest In the past, the thinking was to do everything possible to clear the mortgage check (largest first). However, this method is strongly being challenged as non-consumer friendly. The most consumer friendly posting methodology according to recent court cases is smallest to lowest. CU*Answers currently has thirty-three (33) online clients posting checks/drafts from largest-to-smallest. *Stats not yet available on cuasterisk.com partners nor self processing clients.*
Posting order for transactions:	**Low to High**
Verification of Third Party	[As an example:] “We have contacted XXXXXX requesting that they supply us with the posting sequencing process. We have received email verification that they do not sequence these transactions in any way prior to their being sent to our data processor.”
Risk Evaluation	[As an example:] “Based upon our vendor’s response we feel the transactional risk is low for this channel.” *Although posting from low to high appears as though it is the least likely to be viewed as predatory, a credit union could also make the argument that posting high to low is low risk, because the credit union would never want to bounce a large payment for*

	a mortgage or car payment which would then cause credit problems or large delinquency fines. The evaluation of risk in this section should be well documented in the event the credit union posts high to low.

ACH

Summary of posting method:	Items received are sequenced for posting to member accounts as follows: 1. Transaction code (credits first, then debits) 2. ACH Company ID 3. ACH Depositor ID 4. Sequence # ACH Company IDs, which are part of the incoming ACH items and not controlled by CU*BASE nor the credit union, are not a strictly numeric, sequential code. They can have alphabetic characters, spaces, leading zeros or no leading zeros, etc. For incoming *credits* (deposits), members can specify their own posting sequence for any subsequent distributions being transferred out of the deposited amount. That sequence could also have an impact on a member's individual situation, but since that is defined by the member (set up by the CU employee), it can be adjusted on a case-by-case basis as needed.
Posting order for transactions:	**As stated above in posting methodology**
Verification of Third Party	The Federal Reserve does not sequence transactions in any way. The rules for the posting of transactions are generally dictated by the Federal Reserve and are part of the credit union's annual ACH Audit.
Risk Evaluation	[As an example:] "Based upon our vendor's response we feel the transactional risk is low for this channel as there is no manipulation of the transactions during the posting process and the order is either dictated by the Federal Reserve or controlled by the member."

EasyPay Bill Pay powered by iPay

(For EasyPay bill payment powered by Fiserv, see "ACH" and "Checks" earlier in this document)

Summary of posting method:	EasyPay powered by iPay uses a "good funds" method for posting debits to member accounts. For the purposes of this document, that simply means that we receive a file from iPay, post it to member accounts, rejecting any for which sufficient funds are not available (which stops the bill from being paid), or pay the transaction into a negative balance and charge the member a fee. Transactions received from iPay are posted in the order in which they are presented in the file, with no re-sequencing done by CU*BASE.
Posting order for transactions:	**As presented by vendor**

Verification of Third Party	[As an example:] "We have contacted XXXXXX requesting that they supply us with the posting sequencing process. We have received email verification that they do not sequence these transactions in any way prior to their being sent to our data processor."
Risk Evaluation	[As an example:] "Based upon our vendor's response we feel the transactional risk is low for this channel as there is no manipulation of the transactions prior to posting."

Direct/Mail Posting

Summary of posting method:	This feature lets a CU employee post multiple, unrelated transactions to many member accounts in one place, such as when posting items are left overnight in the night deposit box or mail is opened in the morning. The system simply posts items in sequential order according to how they were entered on the screen in CU*BASE.
Posting order for transactions:	**As entered by CU employee**
Verification of Third Party	None necessary
Risk Evaluation	[As an example:] "Credit union employees post items as they are received and cannot manipulate the order, which would have an impact on member overdraft fees. Therefore we feel the risk is very low."

Summation of Assessment: [INSERT YOUR SUMMARY HERE]

Recommended Changes to Address Potential Risk of Litigation: [INSERT YOUR EVALUATION HERE]

Appendix A

Overview

Xceed Financial Federal Credit Union is the latest financial institution to be sued by consumers in a class action for "deceptive and unfair practices" based on the re-sequencing of transactions. This case follows on the heels of the *Wells Fargo* decision, where Wells Fargo Bank had a $240 million class-action judgment entered against them for "engineering" overdrafts in a deceptive and unfair way.

The purpose of this memorandum is to review the result in the Wells Fargo case to determine how the court came to the conclusion Wells Fargo Bank engaged in unfair and deceptive practices by re-sequencing transactions, as well as an overview on how CU*Answers receives information from our ATM/Debit Card providers. The goal is for our clients to review their practices and determine for themselves whether there may be danger of consumer lawsuits against the credit union for unfair and deceptive practices.

Key items to know:

- Notice to consumers is important regarding transactions processing
- Documentation of consumer preference on transaction sequencing is also important
- Frequency and amount of fees could also be a factor
- CU*Answers ATM/debit card vendors do not re-sequence transactions
- CU*Answers does not re-sequence transactions; credit unions have control in some areas to change the transaction sequencing

Unfair and Deceptive Practices in Wells Fargo

In *Gutierrez v. Wells Fargo Bank* (NA, 730 F. Supp. 2d 1080 - Dist. Court, ND California) 2010, a class action was filed and found in favor of the plaintiffs that Wells Fargo charged hundreds of millions of dollars in overdraft fees on depositors through unfair and deceptive business practices. Note that this decision is currently under appeal, meaning that the decision could be overturned.

The case was filed under Section 17200 of the California Business and Professions Code which prohibited bank actions that are unfair, and the California legislature defined unfair as requiring banks to act in good faith and not establish posting practices for the sole purpose of maximizing consumer penalties. "Good faith" was defined as the *reasonable expectation* by consumers regarding what fees would need to be paid.

The judge analyzed the low-to-high and high-to-low posting process. He found that if a consumer had $100 in a debit account and made 10 purchases totaling $99 and one totaling $100 under the low-to-high the consumer would have just one overdraft; however, under high-to-low posting the consumer would have as many as ten. (Ten overdraft fees was the maximum number of fees Wells Fargo would charge a consumer).

The judge found that high-to-low posting as practiced by Wells Fargo violated California law for the following reasons:

1. Wells Fargo had posted low-to-high until 2001. Wells Fargo made the switch to high-to-low without notice to the consumer, and the posting process was not clear in the subsequent Consumer Account Agreements. The judge stated that while an explanation of the high-to low process was in the Agreement, it was buried in a 60-page document and hard for the consumer to understand. The judge also found fault that the Consumer Account Agreement stated Wells Fargo "may" post transactions from the highest dollar amount to the lowest, when it fact this was the *only* way Wells Fargo processed transactions. The judge found the "may" language to be deceptive.

2. Wells Fargo acted only in its own interest, and not in the interest of the consumer. The judge rejected the Wells Fargo argument that consumers would *prefer* high-to-low re-sequencing, because Wells Fargo had no evidence that this was true. (Wells Fargo destroyed its records from 2001).

3. Wells Fargo co-mingled debit card transactions with ACH and check transactions. This increased the odds that there would be overdrafts. (In fact, the practice raised Wells Fargo's income by $40 million).

4. Wells Fargo added a "shadow line of credit" to debit card transactions. Prior to this practice, Wells Fargo would decline a debit card transaction if there was insufficient funds in the account. Once the shadow line was implemented, Wells Fargo would process the transaction and then charge an overdraft fee. Wells Fargo would complete this authorization without notice to the consumer.

5. For online banking, Wells Fargo account activity information provided to consumers displayed pending debit-card transactions in chronological order, misleading consumers that this is how the transactions would be processed.

Wells Fargo tried to counter these arguments by stating it had overdraft-protection services in place, a limitation of ten overdraft items per day, and a one-dollar overdraft "courtesy threshold." Wells Fargo also argued that by posting a customer's credits first (rather than last), this reduced the number of overdraft items. Wells Fargo also argued that consumers could have avoided the fees with better management of their accounts, and that the bank had a right to increase income through fees. All of these arguments were rejected.

Wells Fargo Lessons

It should be noted that *Wells Fargo* was a decision made under *California* law. Other states may have different standards or no standards regarding unfair and deceptive practices. Although, also note that the Consumer Finance Protection Bureau is able to investigate unfair and deceptive practices.

Having said this, it appears that *how* a financial institution processes transactions, be they low-to-high or high-to-low, is not nearly as important as the *notice* given to the consumer and *what* the financial institution overdrafts the consumer. Wells Fargo might have been correct that the way they processed transactions was preferred by the consumer, but Wells Fargo had no evidence to back up this assertion. Wells Fargo also was hurt by the fact that the shadow line of credit and the co-mingling of transactions was done without notice to the consumer. The judge found that consumers could not have reasonably expected to have up to ten overdrafts; however, if Wells Fargo had fewer overdraft penalties (say only 2-3 or even 5) it can't be known if a lower number of fees might have been considered "reasonable" by the judge.

Xceed Financial FCU Sued For Overdraft 'Batching'

Credit Union Journal Daily Briefing | Tuesday, April 17, 2012

LOS ANGELES – In what is expected to be the start of a new spate of consumer lawsuits against credit unions, a member of Xceed Financial FCU is claiming the credit union engaged in deceptive and unfair practices by re-sequencing his debit transactions in order to create overdrafts in his accounts.

In a purported class action suit filed in U.S. District Court for the Central District of Los Angeles, Cuthbert Shillingford claims the $750 million El Segundo-based credit union engages in so-called batching of debit transactions to pay off the biggest debits first, which causes additional overdrafts and attendant fees.

The charges are similar to those forcing numerous big banks to pay millions of dollars in settlements and come as a class action group in Washington is soliciting potential overdraft suits against credit unions across the country. Over the past year dozens of banks have entered into multi-million-dollar settlements to end similar overdraft suits, including Intrust Bank, JP Morgan Chase, Bank of Hawaii, Fifth Third Bancorp, UMB Bank and Bank of America, which paid out $410 million to settle its suit.

Shillingford, who has been a member of Xceed the past four years, said the practice of re-sequencing, or batch processing, has caused him to pay fees on dozens of overdrafts by having his checking account depleted quicker than if the transactions were deducted in chronological order. He is seeking more than $5 million in damages for what he describes as a class of Xceed members that could number in the tens of thousands.

Representatives of Xceed, the one-time Xerox Employees FCU, did not immediately return a phone call seeking comment.

According to the suit, there are two ways Xceed re-sequences transactions. First, by processing large-dollar transactions before low-dollar transactions, no matter which transactions occurred first. And second, by re-sequencing transactions that occur on different days as if they occurred on the same day. The practice, according to the suit, results in multiple overdrafts when only one might have occurred.

Through the regular use of his debit card, Shillingford says he was charged repeated overdraft fees of $29, which the credit union automatically debits from his checking account. "However," says the suit, "some of these excessive overdraft fees were not proper and were the result of Xceed's re-sequencing of his transactions."

"Thus, Xceed manipulates customer transactions to obtain overdraft fees at the expense of its customers," claims the suit.

Appendix B

Disclosure of Overdraft Options

Overdraft Transfer Plan transfers available funds from existing deposit or line of credit accounts in order to prevent the checking account from being overdrawn. This transfer service may be added/deleted to new/existing checking accounts by the account holder at any time.

Overdraft Privilege Plan allows the transaction to be paid to a predetermined negative limit (when available funds are zero or less). See the Overdraft Privilege disclosure for further details on how this program works.

Option A: No Overdraft Protection (Default)		If you choose not to opt in to the Overdraft Transfer Plan, transactions that would cause an overdraft will be returned unpaid and the account will be charged a non-sufficient funds (NSF) fee.
Option B: Overdraft Transfer Plan		
Overdraft Transfer Fee	**$0.50**	For each time money is transferred from another account
Excessive Overdraft Transfer Fee	**$12.00**	If a share or money market share account is used as an overdraft transfer account, transfers are limited to six (6) per month. Transfers exceeding six (6) will be charged a transfer fee equal to the current NSF fee.
Option C: Overdraft Privilege	**$25.00**	If you do not specifically state you do not want to be enrolled in this plan the credit union may automatically enroll you in accordance with the Privilege plan disclosure. For each item that is presented when available funds are not sufficient to cover the transaction the credit union will charge you the listed fee. This plan only kicks in once the overdraft transfer funds have been exhausted.

;The credit union makes every effort to post items presented on your account in the following order:

1. Checks: lowest amount to highest amount
2. ACH: credits then debits, in the order of Company ID, ACH Depositor ID, and sequence number
3. Debit/ ATM card: as presented by merchant

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