Recent Developments in Overdraft and NSF Practices Claims

April 24, 2024

Executive Summary

Overdraft and returned item/insufficient funds (NSF) programs and fees are not new, but they have come under increased scrutiny in recent years. With little statutory or regulatory authority to define exactly which practices are and are not permissible, banks and credit unions were left to develop these programs based on an evolving set of guidance and best practices, making adjustments as various practices are challenged in litigation. The Consumer Financial Protection Bureau (CFPB) has made it a priority in recent years to scrutinize these programs and fees more closely and issued further guidance in 2022,[1] as well as two proposed rules in 2024,[2] in an effort to curb practices deemed unfair, deceptive, or abusive to consumers. This has also opened the door to similar efforts by state regulators and legislators, as well as state attorneys general, to challenge practices deemed to violate state unfair competition laws.

California's Senate Bill 1415 (2022)[3] began requiring California state-licensed banks and credit unions to submit an annual report to the Department of Financial Protection and Innovation (DFPI) of the amount of revenue earned from overdraft fees and nonsufficient funds fees collected during the prior calendar year and the percentage of that revenue to the licensee's net income. The first report, published in March 2023, triggered a series of negative articles and bad press for credit unions.

In February 2024, the California Attorney General also issued a letter to banks and credit unions,[4] identifying three practices it deemed likely to be an unfair business practice in violation of California 's Unfair Competition Law (Bus. & Prof. Code, § 17200 et seq.) and the federal Consumer Financial Protection Act (15 U.S.C., §5536):

(1) Overdraft fees that significantly outweigh the actual credit risk associated with covering an overdraft;

(2) The practice of "authorize positive, settle negative" (APSN) transactions where a consumer may believe they have sufficient funds to complete a transaction at the time of authorization only to learn that funds are insufficient at the time of settlement due to intervening or previously authorized transactions, resulting in a surprise overdraft fee; or

(3) Fees assessed against a consumer's account for a deposited item that is subsequently returned unpaid, despite the consumer likely having no knowledge or control over the circumstances.

While this is a frustrating development for credit unions, given the Attorney General's enforcement authority over banks and credit unions in the area of California's unfair competition laws, credit unions' options to push back against this opinion are limited. At a minimum, however, credit unions are now on notice and have any opportunity to adjust their programs as needed to steer clear of practices the Attorney General has identified as problematic.

In the meantime, credit unions are also working diligently on the legislative front to oppose California Senate Bill 1075 (Bradford), [5] proposed legislation targeting California's state-licensed credit unions that would impose a five (5) business day grace period before charging an overdraft fee in order to give the

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customer an opportunity to repay the overdraft, impose a limit of three (3) overdraft and/or NSF fees per month, and require credit unions to disclose these requirements to all customers by January 31, 2025, and annually thereafter. This bill is being opposed on a number of grounds, including restrictions that are both unreasonable and unworkable, as well as its unfair targeting of credit unions. It remains a top legislative priority.

Unfortunately, this renewed focus has also reignited the interest of class action law firms who have already begun to file lawsuits and issue demand letters targeting certain practices as unfair, deceptive, or abusive. The most recent activity appears to focus on fees resulting from returned deposit items, as mentioned in the Attorney General's letter. It's important for credit unions to be familiar with the most current guidance as well as the various practices that have come under fire in the past.

The Leagues have provided this communication not only to help credit unions better understand this current landscape, but to help equip credit unions with information necessary to effectively respond to complaints or demand letters and, hopefully, to avoid being targeted.

[1] Consumer Financial Protection Circular No. 2022-06 (October 26, 2022): Unanticipated Overdraft Fee Assessment Practices; Compliance Bulletin 2022-06 (October 26, 2022): Unfair Returned Deposited Item Fee Assessment Practices.
[2] Overdraft Lending: Very Large Financial Institutions (January 17, 2024); Nonsufficient Funds (NSF) Fees for Instantaneously Declined Transactions (January 24, 2024).
[3] California Senate Bill 1415 (Ch. 847, Cal. Stat. 2022).
[4] Letter from California Attorney General (February 20, 2024) re: Surprise Overdraft Fees and Returned Deposited Item Fees.
[5] California Senate Bill 1075 (Bradford) (2024) Credit unions: overdraft and nonsufficient funds fees.

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I. Introduction

There has been a growing criticism among regulators and lawmakers regarding the charging of overdraft, returned deposit item, and insufficient funds (NSF) fees, and it appears to be gaining momentum. We have seen a steady increase in regulatory, administrative, and legislative action, as well as a new round of demand letters and class action litigation based on claims that certain overdraft, returned deposit item and NSF fees and practices are unfair, deceptive, abusive, and/or otherwise violate applicable law. The California and Nevada Credit Union Leagues (Leagues) are providing this communication to keep members informed about recent developments in this area, and to provide an update about actions being taken by the Leagues to address these challenges. Additionally, the Leagues want to encourage members to continue to review their own policies and practices in light of these recent developments and the current environment and take proactive steps to help reduce the risk of becoming a target.

II. Background

The financial services industry is acutely aware of the attention that has been placed on overdraft and NSF fees and programs over the last decade. Given the limited statutory framework for how these programs and fees should be structured, state and federal regulators seem to constantly be playing catch-up with aggressive plaintiff attorneys by issuing guidance and best practices in response to the latest practices targeted as unfair, deceptive, or abusive.

In 2022, the Consumer Financial Protection Bureau (CFPB) issued **Consumer Financial Protection Circular No. 2022-06 (October 26, 2022): Unanticipated Overdraft Fee Assessment Practices** as well as **Compliance Bulletin 2022-06 (October 26, 2022): Unfair Returned Deposited Item Fee Assessment Practices**. These publications shined a light on policies and practices that the CFPB considered unfair, deceptive, or abusive acts and practices (UDAAP) in violation of the Consumer Financial Protection Act (CFPA) (12 U.S.C. §5536(a)(1)(B)). More recently, the CFPB has issued two proposed rules intended to better define their expectations regarding fairness and full disclosure in program practices: **Overdraft Lending: Very Large Financial Institutions (January 17, 2024)** and **Nonsufficient Funds (NSF) Fees for Instantaneously Declined Transactions (January 24, 2024)**.

Unsurprisingly, attention at the federal level has also sparked action at the state level.

Credit unions in California continue to experience the fallout from a series of events beginning with 2022's **California Senate Bill 1415 (Ch. 847, Cal. Stat. 2022)**. SB 1415 requires California state-licensed banks and credit unions to report annually to the Department of Financial Protection and Innovation (DFPI) the amount of revenue earned from overdraft fees and NSF fees collected during the prior calendar year and the percentage of that revenue to the licensee's net income. The first report, published in March 2023, triggered a series of negative articles and bad press, while credit unions pointed out the limited and distorted picture painted by the report and a number of important considerations that were not reflected, not the least of which is consumer choice. The League continues to work with the DFPI to not only identify the report's shortcomings but to find ways to provide the statutorily required information in a context that ensures greater fairness.

Meanwhile, the California Attorney General has also joined the conversation.

III. California Attorney General's February 2024 Letter

In a **February 20, 2024 letter** issued to California banks and credit unions, California Attorney General Rob Bonta took aim at the practice of charging surprise overdraft and returned deposited item fees, taking

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the position that charging these fees in certain circumstances is likely an unfair business practice in violation of California 's Unfair Competition Law (UCL) (Bus. & Prof. Code, § 17200 et seq.) and the federal CFPA. The Attorney General's letter criticized the following three practices:

- Overdraft fees that significantly outweigh the actual credit risk associated with covering an overdraft;
- The practice of "authorize positive, settle negative" (APSN) transactions where a consumer may believe they have sufficient funds to complete a transaction at the time the transaction is initiated only to learn that funds are insufficient at the time of settlement due to intervening or previously authorized transactions, resulting in a surprise overdraft fee; or
- Fees assessed against a consumer's account for a deposited item that is subsequently returned unpaid, despite the consumer likely having no knowledge or control over the circumstances.

Credit unions are understandably frustrated at being singled out by the state's highest law enforcement authority and concerned about the potential for his letter to spark an increase in litigation. While the Leagues have conferred with member credit unions, legal counsel, and shared our collective concerns with representatives from the Attorney General's office, it's important to recognize that the California Attorney General has been following the CFPB's lead on this particular policy issue, having previously voiced his support for the CFPB's actions in this area. And while the CFPB's *enforcement* authority is limited to financial institutions with over $10 billion in assets, there is certainly a fair amount of pressure already on financial institutions of all sizes to follow the CFPB's guidance in this area. It is important to note and for California credit unions to understand that the California Attorney General has enforcement authority over anyone in California engaged in an unfair business practice in violation of California's UCL, which includes California banks and credit unions, regardless of asset size or charter. As such, the Attorney General voicing his opinions to California credit unions and banks regarding what he considers may be unfair business practice is within the authority conferred upon him by the State of California to police UDAAP violations in California.

So while the California Attorney General's letter is no doubt frustrating for our credit union members to receive, given the prosecutorial authority of the Attorney General and the trend we are seeing regarding what is and what is not considered "fair" in this area, his letter should prompt credit unions to review the following items highlighted in the letter to help reduce potential risks in this area, including:

- Overdraft policies, practices, and fees as they relate to ASPN transactions and returned deposited items to ensure fairness to members. Consider whether members have a reasonable ability to anticipate and avoid these fees.
- The amount of any overdraft, NSF, or similar fees to determine whether they are supportable as fair compensation to the credit union in response to the risk and actual cost of the transaction. (*Note: As an example, the letter notes financial institutions charging overdraft fees of up to $36 or more, regardless of the amount of the overdraft, while a recent CFPB report shows the median overdraft for a debit card transaction to be less than $26 and repaid within three days. The result, it says, is an extremely high-interest loan.*)
- Consider implementing additional measures, such as: (a) a minimum threshold to trigger an overdraft fee (e.g., an overdraft in an amount less than $25 will not trigger a fee); (b) a cap on the number of fees that can be charged in a day, a month, etc.; or (c) a grace period during which a member can cure the overdraft in order to avoid or reverse the fee.

In the meantime, the California State Legislature also joined the conversation.

IV. SB 1075: Draft Credit Union Overdraft and NSF Fee Legislation

Senate Bill 1075 (Bradford), as currently proposed, would add new Financial Code §14053 to the California Credit Union Law to impose new restrictions on state-licensed credit union overdraft and NSF fee practices. SB 1075 would:

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(1) Require a credit union to provide a customer a grace period of at least five (5) business days before charging an overdraft fee in order to give the customer an opportunity to repay the amount of overdraft.
(2) Prohibit a credit union from charging more than three (3) overdraft and/or NSF fees per month.
(3) Require a credit union to disclose the above requirements to all customers by January 31, 2025, and annually thereafter.

The Leagues have voiced their strong opposition to this bill on multiple grounds, including: (i) the proposed restrictions, and the grace period in particular, are unworkable from an operational standpoint; (ii) overdraft programs provide a sought-after member service and these restrictions will make it more difficult to provide; (iii) overdraft/NSF fees are designed to not only cover actual costs, but to account for associated risks and provide a deterrent effect; and (iv) the bill unfairly targets California credit unions over other financial institutions. It's still early in the process and discussions with the author's office are ongoing.

Not surprisingly, the current environment also appears to have reignited the interest of plaintiff's bar.

V. Recent Class Action Litigation

The Attorney General's letter, coupled with proposed federal regulation and state legislation, appears to have brought renewed attention to this issue not only from the banks and credit unions to whom the letter was directed, but from class action litigation firms. At least three larger banks have been named in class action lawsuits, while some credit unions and others have received demand letters, alleging violations of unfair competition laws. While we are still collecting specifics, it appears that the focus of this latest round of litigation and demand letters is on **fees resulting from returned deposit items** during the past three to five years. We are aware of at least one law firm – Siri & Glimstad, LLP – that has been actively reaching out to prospective class members. They appear to operate a website titled *JoinClassActions.com*, a sort of class action lawsuit clearinghouse featuring dozens of class actions on a variety of issues, including **bounced check fees**. The website invites consumers to request a "free case evaluation" to determine whether they are eligible to join the class and includes a list of financial institutions they are "investigating," including a couple of larger credit unions.

VI. Practices Sparking Criticism and/or Litigation

In light of what we are seeing from the CFPB, the Attorney General, the California legislature, and consumer class-actions law firms, again we recommend credit unions review their current practices, policies, and fees regarding overdrafts and returned items to either consider making adjustments to those practices, or at least better understand the potential risk to credit unions engaging in certain practices in this area. The following is a list of some of the practices that have been the subject of regulatory criticism, regulatory action, and/or consumer litigation in recent years that credit unions should have on their radar when reviewing current practice and polices:

(1) "Authorize Positive, Settle Negative" (APSN) transactions, where available funds are reserved or set aside when a debit card transaction is authorized but an overdraft fee is assessed because the funds were insufficient at the time of settlement, despite the funds being held in reserve.
(2) Charging overdraft/NSF/returned item fees resulting from the deposit of a third-party item that was returned.
(3) Charging overdraft/NSF fees that could not be anticipated due to unpredictable, internal-process timing of intervening transactions outside of a consumer's control (i.e., a "surprise" charge).
(4) Charging overdraft fees that are disproportionate to the amount of the actual overdraft, e.g., assessing a $35 overdraft fee when the available funds are only insufficient by $1.
(5) Charging multiple NSF funds fees for repeated attempts to process a single transaction or debit when there are insufficient funds.
(6) Charging extended overdraft fees for accounts the remain overdrawn for a specific period of time.

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(7) Reordering transactions or posting debits and credits to an account in a manner designed to maximize overdraft fees, e.g., largest to smallest rather than order received.
(8) Charging excessive overdraft or NSF fees when an automated system results in the financial institution rendering little or no actual service to the consumer; charging an NSF fee for automatically declined transactions (per CFPB's recently proposed rule).
(9) Failure to obtain a consumer's affirmative consent (opt-in) before assessing overdraft fees on ATM and one-time debit card transactions per Reg. E; failure to provide written confirmation of the consumer's affirmative consent (opt-in), including the right to revoke consent.
(10) Providing insufficient disclosures in connection with obtaining affirmative consent (opt-in) for overdraft fees on ATM and one-time debit card transactions per Reg. E (*Note: Reg. E's Model A-9 requires a significant amount of additional information.*)
(11) Charging an intrabank transfer fee to Account A for moving funds from Account B to cover an overdraft on Account A, but then also charging an overdraft fee to Account B if funds were insufficient to cover the transfer.
(12) Failure to provide adequate disclosure of overdraft fee practices; misrepresenting overdraft practices; charging overdraft/NSF fees in conflict with the account agreement or overdraft disclosures.
(13) Failing to notify consumers of overdrafts.
(14) Excessive or unreasonable overdraft/NSF fee amounts.
(15) Depositing funds in an irregular manner, causing the customer to exceed their withdrawal limit.
(16) Charging an overdraft or NSF fee based on an insufficient "available" balance but failing to adequately describe the distinction between the "available" balance or the "actual" (ledger) balance or identify which one will be used in the disclosure and agreement.
(17) Charging an overdraft fee on a transaction that never actually overdrew the account, e.g., an overdraft fee assessed based on an insufficient available balance where the actual balance never falls below $0.

This list is not exhaustive and credit unions are encouraged to review all available guidance and work with legal counsel to ensure that they are following the most current best practices.

VII. Actions Credit Unions Can Take

Before ever receiving notice of a potential claim, credit unions are encouraged to do the following:

- Initiate a conversation with the credit union's insurance provider to ensure that coverage is adequate in light of the current environment and the credit union's current overdraft/NSF practices. Ask questions about coverage limits and exclusions, review deductible amounts, and be familiar with any notice requirements.
- Regularly review overdraft and NSF policies, disclosures, and practices to ensure compliance with the latest regulations and guidance, as well as consistency between policies, disclosures, and actual practices. Work with legal counsel to ensure that disclosures are clear, accurate, complete, and compliant. Review applicable fees to ensure that they are reasonable, supportable, and consistent with the most current guidance.
- Determine whether the credit union has a consumer arbitration agreement with a class action waiver in place. Review when, and the process by which, the arbitration agreement was communicated to members, as well as the process by which it was accepted by members (if applicable) to ensure its effectiveness and sufficiency.

Once a credit union is on notice that it has been, or may be, named in a lawsuit pertaining to overdraft or NSF fees, it is important to act quickly. Upon receiving a demand letter or being served with a summons and complaint, credit unions are encouraged to promptly contact their legal counsel as well as their bond carrier to discuss next steps.

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Credit unions are also encouraged to notify the Leagues so that the Leagues can stay on top of developments in this area and determine how to best assist members.

Regardless, it's important to note that these recent developments are consistent with the direction in which the federal government and the states have been moving for some time now, so a full course reversal is unlikely. The Leagues will continue to track these developments to ensure that credit unions remain part of the conversation, but credit unions also need to acknowledge the current environment. Overdraft and NSF programs, practices, and fees are likely to remain under intense scrutiny as potentially unfair practices to consumers. Regulators have already indicated that financial institutions should move away from reliance on overdraft and NSF fees as a significant source of income and efforts to limit fee practices are likely to continue. The best defense, therefore, continues to be a good offense – ensuring that programs are compliant and incorporate the most current best practices, and that disclosures are clear, accurate, and complete.

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