

OCC Extends Comment Period on Deposit-Related Consumer Credit Products

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In a proposal published in the Federal Register on June 8, 2011, the Office of the Comptroller of the Currency (“OCC”) issued guidance (“Proposed Guidance”) addressing issues related to the safety and soundness of deposit-related consumer credit products.¹ On July 1, 2011, the OCC extended the comment period on the Proposed Guidance 30 days, from July 8, 2011, to August 7, 2011, to “allow interested persons additional time to analyze the proposed guidance and prepare their comments.”² The Proposed Guidance specifically highlights concerns with national bank (and federal thrift³) automated overdraft protection programs and direct deposit advance programs.

While primarily focused on safety and soundness, the Proposed Guidance unmistakably implicates issues with respect to consumer financial protection, supervision of which with respect to large banks and thrifts (with assets greater than \$10 billion) is scheduled to shift from the OCC to the Consumer Financial Protection Bureau (“CFPB”) on July 21, 2011.⁴ In particular, the OCC notes in the Proposed Guidance that it is intended “to address potential operational, reputational, compliance, and credit risks”⁵ to a national bank or federal thrift with respect to deposit-related consumer credit programs. Notwithstanding the reference to automated overdraft protection and direct deposit advance programs, the issues discussed in the Proposed Guidance serve as important discussion points in the overall supervision, regulation, and jurisdiction of large bank and thrift consumer credit products. Accordingly, institutions should carefully review and understand the Proposed Guidance as it relates to deposit-related consumer credit products (and provide comments to the OCC as they deem appropriate), while being mindful of the broader implications and expectations of the OCC for national banks and federal thrifts with respect to supervisory concerns and issues that straddle safety and soundness and consumer financial protection.

Overview of Proposed Guidance

As noted in the OCC’s July 1, 2011 extension of the comment period for the Proposed Guidance, the guidance “addresses concerns related to product disclosure and enrollment; legal compliance; program availability and prudent eligibility standards; prudent limitations on product costs and usage; ongoing monitoring and risk assessment; and management oversight.”⁶ The two appendices to the Proposed Guidance discuss the application of these principles to the two deposit-related consumer credit products specifically highlighted in the guidance – automated overdraft protection and deposit advance products.

As noted in the Proposed Guidance, the “principles articulated in [the] guidance are predicated on the premise that bankers should provide their customers with products they need, and that bankers should not use these products to take advantage of their customer relationship.”⁷ The guidance further notes, “[t]he OCC expects bankers and examiners to use sound judgment and common sense when applying these principles to specific programs and products.”⁸ The following principles are set forth in the Proposed Guidance:

- **Product Disclosures** – A hallmark of sound consumer financial protection, the guidance advises institutions to provide customers with clear and conspicuous disclosures about program costs, terms, and material restrictions before providing a deposit-related credit product.
- **Alternative Product Offerings** – Institutions should also provide customers information about any alternative deposit-related credit products they offer.
- **Legal Compliance** – Deposit-related credit product offerings and marketing should comply with applicable law, including laws addressing unfair and deceptive acts and practices.
- **Enrollment Protocol** – Institutions should ensure that customers are not automatically enrolled in product programs, but do so based on an affirmative request after receiving appropriate disclosures and agreeing to abide by product terms, including fees. Account disclosure and marketing materials should note the optional nature of the product.
- **Customer Suitability and Use** – The guidance also notes that an institution should have sufficient information about the customer to evaluate that the customer meets the bank’s eligibility standards for a deposit-related credit product, as indicated below. Further, an institution should not promote customers’ routine use or undue reliance on such products.
- **Program Availability and Prudent Eligibility Standards** – Institution policies and procedures should specify the eligibility criteria for a customer to obtain the deposit-related credit product; and institutions should conduct sufficient diligence to ensure that a customer will be able to manage and repay the credit obligations arising from such product.
- **Prudent Limits on Product Costs and Usage** – Institutions should also set prudent limitations on credit extensions, customer costs and usage, all of which should be based on safe and sound banking principles, and should take into account potential reputation and strategic risks. Institutions should be vigilant in avoiding undue reliance on the revenue and earnings generated by a particular product.
- **Risk Monitoring and Assessment** – Institutions should regularly monitor deposit-related credit product volumes and revenue to identify risks arising from customer changes in usage; and take appropriate action to address risks from excessive usage and nonperformance. The range of institution responses should include reassessing customer creditworthiness; adjusting credit terms, fees, and limits; suspending or terminating a credit feature; and/or closing an account.
- **Management Oversight** – Bank management should oversee and monitor new products and services via regular reports on product usage, fee income, and legal compliance, and through periodic audits.

- **Third-Party Vendor Management** – Management oversight should also include monitoring third-party vendors that provide services related to any deposit-related credit product.
- **Account Management and Charge-offs** – Finally, institutions should maintain and manage account management guidelines for credits and charge-offs of uncollectible balances.

Generally, the OCC expects bank management to be vigilant in assuring adherence to the above principles set forth in the Proposed Guidance and to take immediate steps, when appropriate, to address noncompliance and reputation risks. The appendices to the Proposed Guidance apply an analysis of these principles to automated overdraft protection programs (Appendix A) and Deposit Advance Programs (Appendix B).

Safety and Soundness Expectations for Automated Overdraft Protection Programs

In applying the supervisory principles set forth in the Proposed Guidance to retail overdraft protection programs, the discussion in Appendix A notes that these programs have evolved significantly since 2005, when the federal banking agencies issued their Joint Agency Guidance on Overdraft Protection Programs (“Joint Guidance”).⁹ With the substantially increased volume of electronic transactions since 2005, the Proposed Guidance notes, “overdraft protection has evolved from a program that functions primarily in the context of check-based overdrafts to one that functions increasingly in the context of electronic payments-based overdrafts.”¹⁰ As a result, institutions are faced with new operational risks and increasing credit risks posed by customers who regularly use overdraft protection products. Of particular concern to the OCC are institutions’:

- Excessive reliance on fee income from overdraft protection programs;
- Failure to impose responsible limits on customer costs and imposition of fees that cumulatively exceed a customer’s overdraft credit limit;
- Failure to assess a customer’s ability to manage and repay overdraft protection before it is made available to the customer;
- Failure to monitor overdraft protection usage to identify excessive usage and credit risks and to take steps to address credit risks;
- Failure to charge off overdrafts in a timely manner;
- Failure to ensure adequate risk management of overdraft protection programs, with appropriate internal audits and compliance reviews;
- Failure to monitor and control promotional and sales practices for potentially misleading statements; and
- Payment processing intended to maximize overdrafts and related fees.¹¹

Appendix A to the Proposed Guidance is intended to update the 2005 Joint Guidance, and apply the principles of the Proposed Guidance to automated overdraft protection plans covering electronic overdrafts, including ATM, point of sale, preauthorized debits, and online banking transactions, as well as check-based overdrafts. The Proposed Guidance provides a detailed analysis of the principles noted above, with a particular emphasis on program availability and prudent eligibility standards, including ensuring that such programs have an “opt out at any time” feature for customers.

Safety and Soundness Expectations for Deposit Advance Programs

Appendix B to the Proposed Guidance notes that deposit advance products are “short-term, open-end lines of credit that are generally made available to retail account holders with recurring direct deposits.”¹² These products typically involve one or more line of credit advances limited to the amount, or a portion of the amount, of an anticipated deposit, are in fixed dollar increments with a flat fee assessed for each advance, and are subject to repayment (including fee and finance charge) during a single deposit cycle. Of particular concern to the OCC with respect to these products and programs are institutions’:

- Failure to evaluate a customer’s ability to repay the credit line appropriately, taking into account the customer’s recurring deposits and other relevant information;
- Requiring full repayment of the advance out of a single deposit, which reduces the funds available to customers for daily living expenses, which can cause overdrafts;
- Steering customers who rely on direct deposits of federal benefits payments as their principal source of income to deposit advance products;
- Failure to disclose the costs of deposit advances; and
- Failure to monitor accounts for excessive usage and costs.¹³

Similar to the discussion in Appendix A, Appendix B details how the OCC proposes to apply the safety and soundness principles noted above to deposit advance products.

Action Plan – Commenting on the Proposed Guidance

If you are management of a national bank or federal thrift offering automated overdraft protection products, deposit advance products, or other similar deposit-related consumer credit products, you should carefully review the Proposed Guidance and consider providing comments to the OCC regarding aspects of the proposal that raise potential operational, compliance, reputational, and/or credit risk concerns to your institution. In particular, you should consider comments that you deem particularly important based on your experience with deposit-related consumer credit products and your institution’s program operations. In this regard, you should consider highlighting concerns with particular aspects of the Proposed Guidance or bolstering important points that you want to support. In reviewing whether to comment on the Proposed Guidance, we recommend that you review the following:

1. The extent to which your institution offers deposit-related consumer credit products and an assessment of the potential exposure of your institution’s current program(s) to operational, compliance, reputational, and/or credit risks.
2. The extent of your institution’s reliance on deposit-related consumer credit products for revenue and earnings, and the potential impact of the Proposed Guidance on income.
3. In connection with a review of your institution’s current deposit-related consumer credit programs, consider the potential impact of the Proposed Guidance on the products offered in such programs, including the costs and resources that would be required to comply with the Proposed Guidance.

4. Whether the supervisory principles set forth in the Proposed Guidance accurately address potential operational, compliance, reputational and/or credit risks with deposit-related consumer credit programs, including whether such principles overstate or understate such risks.
5. To the extent you favor aspects of the Proposed Guidance, consider a comment letter highlighting particular benefits to you and your customers given that the OCC could pursue more stringent requirements absent meaningful comments on the proposal.
6. If there are aspects of the Proposed Guidance that are flawed, or engender important issues requiring further revision or clarification, consider submitting comments on the proposal to address these issues and concerns.

Paul Hastings attorneys are actively working with clients to identify and address the impact of the Proposed Guidance on their operations, and are available to assist in drafting comments on the OCC proposal. Again, comments are due to the OCC by August 7, 2011.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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¹ 76 Fed. Reg. 33409 (June 8, 2011).

² Federal Register Notice, OCC Docket ID OCC-2011-0012 (July 1, 2011).

³ The Proposed Guidance notes that, pursuant to Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), the OCC will assume jurisdiction of federal thrifts on July 21, 2011. Thus, the Proposed Guidance with respect to national banks will also apply to federal thrifts after July 21, 2011.

⁴ Pursuant to the Dodd-Frank Act, the transfer of supervisory jurisdiction of consumer financial protection of large banks could be delayed six months until January 21, 2012. Given that a nominee for the position of Director of the CFPB has not been put forth as of the date of this article (and significant delays are anticipated with respect to confirming a nominee), it does not appear the CFPB will be able to assert its supervisory powers as contemplated by the Dodd-Frank Act on July 21, 2011. Thus, the extension to January 21, 2012 is expected.

⁵ 76 Fed. Reg. 33410.

⁶ OCC News Release NR 2011-87 (July 1, 2011).

⁷ 76 Fed. Reg. 33410.

⁸ *Id.*

⁹ See 70 Fed. Reg. 9127 (February 24, 2005).

¹⁰ 76 Fed. Reg. 33410.

¹¹ 76 Fed. Reg. 33411.

¹² *Id.* at 33412.

¹³ *Id.*

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