A Reg DD Fork in the Road

By Ken Johnson

In February 2005, the Federal Reserve, the FDIC, and the OCC issued Guidance on Overdraft Protection Programs and Best Practices. The OTS issued seperate guidance that same month. In May 2005, the Federal Reserve released Final Amendments to Reg DD. Those Reg DD Amendments will become effective July 1, 2006, for banks and thrifts. As a result, all banks are at a fork in the road regarding how to respond to the new amendments.

While the Reg DD Final Amendments contain provisions that affect all banks' disclosures, the primary focus hinges on whether a bank "advertises" its discretionary overdraft services. If it is determined that a bank advertises its discretionary overdraft services, there are additional disclosure requirements. However, many bankers still misunderstand the Fed's definition of the word advertises for the purposes of Reg DD.

Normally, the word advertises conjures up notions of media advertising in newspapers or billboards. However, the Fed's definition of advertising simply means making full disclosure of any specific features and benefits of the bank's overdraft services. General, nonspecific disclosures will not constitute advertising.

For example, the Fed says banks will not trigger additional disclosure requirements if they provide "informational or educational materials concerning the payment of overdrafts if the materials do not specifically describe the institution's overdraft service." So bankers can tell a customer, "Yes, we provide overdraft services, but we can't define how they work. You'll have to figure it out for yourself." This seems an unlikely choice.

In July, if a bank advertises its overdraft services, it is required to make additional disclosures on its periodic statements for at least two years. Banks that advertise (or have advertised) will be required to provide the following information on consumer deposit account statements:

- Separate totals for fees charged for returning insufficient funds (NSF) items unpaid.
- Separate totals for fees charged for paying insufficient items into the overdraft (OD).
- All other fees related to NSF and OD services such as periodic overdraft fees, and related interest charges.
- Totals for the current statement period and year-to-date.

What Caused These Amendments?

Historically, banks have not disclosed how their overdraft services work. It was a behind-the-scenes process left to the discretion of bank insiders.

Bankers tried to balance additional service for the customer against the related risk of loss. Bankers had different opinions as to what was right. Understandably, they tended to give an extra measure of service to customers they knew. Decisions did not follow a coordinated risk management process. This process was uncertain and mysterious to many customers. All too often, customers who did not have a personal relationship with their banker would bounce checks. Bounced checks meant additional costs and embarrassment. Many customers had to accept the NSF experience or look for alternative financial services providers.

In response, many bankers tried to improve overdraft services. They standardized services and disclosed their guidelines to customers. Services were applied more consistently, and customers soon found the bank was paying more items and bouncing less.

Once customers understood, some chose to use the OD service more often and willingly paid the fees. It was less expensive and easier for the customer. The federal banking agencies recognized that fact in a 2004 brochure entitled "Protecting Yourself from Overdraft and Bounced-Check Fees."

Staying in Good Graces

Bankers who deliver a good service should want everything to be in the clear. Banks send notices to customers every time an account has NSF or OD activity, and statements reflect NSF and OD activity and related charges. The new Reg DD disclosure information simply is the third rendition of the same information, with new year-to-date totals.

Most bankers want their customers to understand the benefits of services provided along with the related costs. In some cases customers might actually change their behavior. What community banker wouldn't be happy to see their customers make better financial decisions as a result of information the bank provided to them?

In the end, statement disclosure concerns likely will be a tempest in a teapot.

Banks may experience a few inquiries from customers but, for the most part, it will be a non-event. Likewise, three banks that implemented Reg DD statement disclosures on January 1, 2006, reported no significant customer reaction.

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