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## **Overdraft / NSF Best Practices**

In light of the continued threat to overdraft programs and negative media and legislative scrutiny on both overdraft and NSF practices, the MCUL asked for volunteers willing to serve on an Overdraft Task Force to craft a survey to our Michigan credit unions as well as establish best practices. We had credit unions of all asset sizes participate in the task force and we thank them for their guidance and assistance.

Recently, the MCUL, in partnership with the Overdraft Task Force, published a survey for the MI State credit unions as a means of understanding where our states' credit union's stand as it relates to overdraft and NSF practices. In this survey, we asked respondents to provide their own recommendation best practices, which were then reviewed by the Overdraft Task Force. Of the 208 credit unions in the state, we received responses from 139 (67%), representing one of the League's most comprehensively responded-to surveys to date.

Overall, the survey that was conducted this year of our Michigan credit unions revealed that up to 15% of their overall membership receives at least one overdraft and/or NSF fee monthly. However, 50% of the survey responses revealed that a majority of the impact is centered on only 1-5% of their members, made up of largely low- to mid- income individuals and families. We also found that 72% of respondents indicated that a transaction of any amount may trigger an overdraft or NSF fee and almost half of the respondents indicated that there is no minimum grace balance before an overdraft or NSF is applied. We recommend you consider these results and consider the best practices outlined below as you reflect on possible changes.

We recognize that overdraft is a service that members opt-in to. We hear from a lot of credit unions that members want this service. While the MCUL strongly encourages credit unions to dig into the data at your credit union to understand it's impact, as outlined below, we remain opposed to legislative or regulatory limits on overdraft. We believe the scrutiny both overdraft and NSF are receiving by lawmakers and the negative rhetoric in the media should lead you to review your program and consider modifications.

### **BEST PRACTICE CONSIDERATIONS**

#### **1. Understand the member impact of your current program.**

Approximately half of survey respondents provided input on questions regarding their program's member impact – demographics of program users, credit union income generated, charge-off's and recoveries, etc. It is assumed that, for those that didn't respond to these questions, that the information being asked about was not available at the time. With that in mind, we recommend you obtain an understanding of your program(s), particularly:

- a) What percentage of your total membership incurs fees related to these services?
- b) Of that percentage, what is the breakdown of the income demographics of the users?
  - i. Low Income, Middle Income, High Income?

- ii. What percentage of the overall program volume can be attributed to each income bracket?
- c) What percentage of the program's users' accounts have been charged off as a result of using it? What percentage has been recovered

Note that, in many cases, you will likely need to have custom reporting ordered from your core service provider to identify the data points.

## **2. Understand how your core service provider assesses fees, including transaction types, transaction flow and core limitations that may be present.**

Responses collected from the survey, as well as comments expressed during industry calls over the past months, have indicated that many credit unions are limited by their core processor on what changes they can make to their overdraft and NSF programs. Some core processors, for example, are not complex enough to make program updates that the credit union has requested. The following list is not comprehensive, but represents some of the transaction elements to identify, as well as challenges that could be present that would be important to know:

- a) How does your core post fees? Is it based on the transaction, only? Does member relationship level adjust how fees are processed?
- b) Are fees assessed differently based on type of transaction? i.e. ACH vs debit vs drafts.
- c) Does the core allow for the credit union to input their own criteria regarding how fees are assessed? Can the credit union:
  - i. Establish de minimus transaction amounts, where if the transaction is less than a certain dollar amount, no fee will be assessed?
  - ii. Establish grace balance amounts, where no fee is assessed if the account remains within a certain negative balance threshold?
  - iii. Establish grace periods, where no fee will be assessed if the account is brought back to a positive balance within a certain amount of time?
  - iv. Can the credit union determine whether or not to charge a fee based on membership type or relationship status (such as BankON accounts)?
  - v. Can the credit union determine whether or not to charge a fee based on transaction type (ACH, debit, etc.)?

Prepare your credit union by researching the issues you may have with your core and internal processes. At a minimum, understand what your issues are and then have a solution identified so that when you determine that a change is necessary, you know what direction you are able to move in.

## **3. Understand the impact of your programs on the credit union's income statement.**

Unlike large banks, it is not a requirement to identify and record overdraft- and NSF-specific income on quarterly Call Reports. This tends to result in most credit unions not being aware of the full impact of their programs on their income statement. This was a data point that was elucidated in the results of the recent survey, as many credit unions did not respond to questions related to the potential financial impact of making changes to their programs.

With that in mind, it is recommended that you identify these programs individually as a percentage of your overall revenue stream. If you want or need to make adjustments to your programs, identify what impact those changes will have on your revenue. If you are able to perform stress tests on the information you've collected, use several different criteria to determine what the financial impact will be based on a few different scenarios. If it is determined that an income loss is unavoidable, what options, products or services can you implement to replace some of the lost income? Prepare now.

**4. Determine what changes you will implement, even if those changes are not going to be made until well into the future, and prepare accordingly.**

Even if you decide that changes to your programs are currently unnecessary, given the current tumultuousness of the space, it's important to plan ahead. Once you've identified the processes and limitations of your core service provider, use that information to determine what changes you will be able to implement, should that time arise, and make any updates to policy, procedure, and disclosures that may follow from the changes being implemented. If there are multiple directions available at your disposal, it may be worthwhile to have several plan packages prepared.

**5. Possible program changes to consider when evaluating your own programs.**

While the CFPB has not yet promulgated any regulatory updates following their recent request for information, we are aware that these programs are, at least, in their sights. The industry has made reasonable arguments that the CFPB does not have the authority to regulate away any particular fees. Notably, based on communications and testimonies provided by the CFPB's Director Chopra, it does not appear that regulating the fees away is a tactic they are exploring. That said, over the years, the CFPB has published reports, studies, blog posts and the like that allow us a window into what they are thinking and provide us an opportunity to infer any possible regulatory changes that may be coming.

It is our best guess that the CFPB, if they make any regulatory updates at all, will update them in such a way as to require complexity within programs being offered. Our best guess is that the CFPB will require that financial institutions ensure they have a program that allows for deminimus transactions, grace balances and grace periods.

Our survey results appear to indicate that many of the survey respondents have been able to infer similarly. When asked to provide best practice considerations, these four items were the most repeated response:

- a) De Minimus Transactions – Set a minimum transaction amount that would need to be surpassed prior to assessing a fee.
- b) Member Education – Provide educational resources, financial counseling or coaching for all members, but particularly for those who have a propensity for accumulating multiple fees.
- c) Maximum Fee Accumulation – Set a maximum number of fees that a member can receive any given day/month/year.
- d) Grace Balances – Establish an amount that an account can be overdrawn prior to receiving a fee.