A CEO's Thinking on Regulation E

Some Thoughts from Randy Karnes, CU*Answers CEO, on the Reg. E Opt In Process
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These comments are a different kind of introduction to one of our topical reference booklets. They are very specific to the current industry conditions related to the new Reg. E Opt In provision, and address many of the short-term options credit unions are facing as the new reg. comes into effect.

This is the hardest regulation of 2010 for credit unions, as it is one that requires *salesmanship.* You have to craft a service and then get a positive confirmation that the member wants the service. The reason this is tough is that credit union camps are split in their motivations: the "consumer protectionist" camp, the strict "rule compliance and interpretation" camp, and the "reality of needing the income stream and avoiding negative savings account losses" camp.

Lingering doubts about the service and the issues with holds and posting conditions make the application of the rule difficult for sales people to commit to the sale. When members challenge the process, the sales person has a hard time overcoming obstacles. The MSR and the consumer are confused by the multiple scenarios for how a transaction was designated as a Courtesy Pay or NSF transaction. This is compounded by having two balances involved (current and available) and multiple reasons for the negative status (outlined below). Committing to the service is tough when confusion abounds in so many cases. Therefore, your vision for the *service* you are selling, the *service for which members are opting in*, must be compelling.

Unfortunately, it will take some time for most credit unions and technical networks (probably for good reason) to see how their peers, competition, and consumers crack the problem. What will fly with regulators? What will fly with consumers as a mass audience? What will fly with the people who count on these transaction postings? While it is easy to the CEO or CFO ("the transaction posted to a negative balance, available or current...so it deserves a fee!"), the sales and service aspects are not as easy in practice. It will take commitment and vision for the service. It will require evolution as the marketplace responds, and it will take experience to do it well.

Approved vs. Non-Approved, Expected vs. Unexpected

When you think about your overall NSF and Courtesy Pay income, you must segment how you make income on ATM and Debit Card negative balance postings. It's a mixed bag: remember that **all of these transactions are force paid** if they clear the initial approval process.

There are two ways to clear the approval process at the point of the transaction (retailer or ATM machine):

1. First, the member's transaction is verified and agreed to by the CU (live communication), and
2. Second, the member's transaction is just passed to the CU. In this case there was no direct communication or the item was posted against a static negative balance file (NBF) or positive balance file (PBF).

Either way the transaction now belongs to the credit union. Of course a member just wants his transaction to be approved; he doesn't know (or probably care) which party approved it.

Conditions that Cause Negative Posting

So how do you get a negative posting on an ATM or debit card transaction?

1. The member's current balance is positive prior to posting, but short of the amount of an unexpected transaction (there was no verification or NBF or PBF).

2. The member's current balance is already negative prior to posting an unexpected transaction (no verification or NBF or PBF).
3. The member's current balance is positive, but the *available* balance is short due to other holds and not able to cover an unexpected transaction (no verification or NBF or PBF).*
4. The member's current balance is positive, but the *available* balance is short due to other holds and now not able to cover the amount of an *expected* transaction (even though there was verification).*
5. The member's current balance is negative and not able to cover the amount of an expected transaction (even though there was verification).**

*Shortages in *available* balance occur for various reasons even though the transaction was verified and the funds held. For example, other postings might occur between the verification and the hold, such as ANR limit postings, exceptions in hold processing, forced fees, unexpected transactions, overrides, etc.

**A negative *current* balance can occur for various reasons even though the transaction was verified and the funds held. For example, other postings might occur between the verification and the hold, such as ANR limit postings, exceptions in hold processing, forced fees, unexpected transactions, overrides, etc.

You have to remember that even if the member opted out of Debit/ATM overdraft services, they may very well be part of your Check and ACH Courtesy Pay program. Therefore, you are posting them into their negative limit for valid reasons, but when non-verified Debit or ATM activity shows up, the member who Opted Out will not be charged the fee, according the rule.

Things for Program Designers to Consider

Some questions for your overdraft service designer program and our programming teams to consider:

- Can we analyze what percentage of Debit and ATM Card ANR fees and NSF are related to the 5 conditions above? This is a tough one, but we imagine in the future we'll be able to get a handle on it.

- Should credit unions allow members to be part of a Checking and ACH Courtesy Pay program and Opt Out of the Debit and ATM side? Debit and ATM transactions will eat up limits and post more negative balance transactions this way without fee income. This would result in more Checks and ACH items being declined because the limit is being used elsewhere. This results in less income and more NSF on Checks and ACH for some members. **Should Courtesy Pay be an all-in or all-out process? Does that make a more compelling argument to take the service?**

- Should CU*BASE® estimate the non-verified transactions when the amount fits a test (for example, if a transaction is under $25, assume it was *not* verified), and then, if that item takes the account negative, post a fee as if the transaction had not been approved.

- How long will it take for all of the networks to catch up with identifying recurring debit card transactions and non-verified transactions for smart postings?

- Should CU*BASE waive fees in a *matched* hold/post condition for debit card transactions? This would help to compensate for an imperfect hold system.

- Should CU*BASE put in a tracking system for approved and non-approved negative balance posting, and automate the suspension of service on ATM and Debit Cards (reports, hot card, etc.)?

- Should CU*BASE go even deeper, and give members the option on whether negative balance limits are included in authorizations as well as postings? *"I opt in for your overdraft services, but please do not include the extra limit when authorizing transactions for my debit card. I want the posting protection only."*

Getting Started This Summer

And now here is the really tough part. In June and July, 2010, your teams will start to record your members' response to your service offering, in anticipation of the new selective fee posting processes — even before all of the kinks are worked out in the posting programs or the rule truly goes into effect.

That means your team is looking for your leadership and patience in these uncertain times. What do you do with new members between July 1 and August 15? What do you do with existing members between July 1 and August 15? What will you do since the posting programs cannot be released until July 18 or later?

This regulation has a lot of people feeling queasy from the shifting sand under their feet. **Your vision for selling a *service* is the key, but you will have to modify your approach over time.**

Some things to address during the six weeks of transition:

1. How do you explain to existing members that their decision to Opt In or Out will not be enforced until August 15? **You need to attack the project NOW!**
2. How will you explain to new members (July 1 – August 14) that their decision to Opt In or Out will be in effect immediately, but the software may charge them a fee in error prior to the posting programs going live, and that you will take care of reversing the fees immediately? **You have to ask the Opt In question, even though the posting program changes are late and still in flux.**
3. Should you consider waiving all ATM and Debit Card NSF fees during this 6-week period? **Expensive and clear to new members but confusing to your existing ones (on, off, on again)?**
4. Should Courtesy Pay be an all-in or all-out process? Does it make a more compelling argument to take the service?
5. If your CU has always used ANR in the posting of Debit and ATM card transactions, but not in the approval or authorization process, should that change? If yes, you will create more negative transaction postings – is this a good or a bad thing? **Will members opt in more because of it (member wants the extra money in the Yes), or will the member shy away (member likes the safety blanket when it posts, but does not wish to overspend his account)?**

An Opportunity for Credit Unions to Shine

There is one wrinkle I like here, and one that may serve us all well. In making Courtesy Pay a service that must be sold and verified by the consumer, the regulator gives credit unions an opportunity to differentiate themselves from the bad actors, openly for everyone to see. Let's see what the industry does with that.

Courtesy Pay is a good service. It spares members extra fees and saves money when applied fairly. It spares members reputation risk and community standing by making the transaction conditions private between their financial institution and themselves. It lowers the cost of servicing negative accounts (return fees, collection fees, etc.). And finally, it creates another service for credit unions to use to bond with the member: value exchanged and appreciated. Until this time, the service has not been as transparent as it could be. This is an opportunity for credit unions to shine.

Let's hope we can all turn lemons into lemonade – and we get some relief from the rule designers as the flaws are brought into the light.