September 22, 2023

Consumer Compliance Outlook®

A Federal Reserve System Publication Focusing on Consumer Compliance Topics

Compliance Spotlight — Focusing on a Specific Compliance Topic

Supervisory Observations on Representment Fees

BACKGROUND AND OBSERVATIONS

Through supervisory examinations, the Federal Reserve recently analyzed the practice of imposing fees on represented transactions at several supervised institutions for compliance with applicable federal consumer financial laws.

As background, a representment occurs when, after a bank declines to pay a debit transaction from a consumer's checking account because of insufficient funds, the merchant presents that same transaction again to the bank for payment. Examiners identified more than one institution that charged a nonsufficient funds (NSF) fee when a transaction was first presented and declined and also charged additional NSF fees each time the same transaction was represented and declined.

At more than one supervised institution, examiners cited the assessment of NSF fees on represented transactions as an unfair practice in violation of Section 5 of the Federal Trade Commission (FTC) Act, which prohibits unfair or deceptive acts or practices (UDAP), based on the following findings:

- The assessment of NSF fees on represented transactions resulted in a substantial injury in the form of monetary harm that affected a large number of consumers.
- Consumers were not in a position to reasonably avoid this harm because:
    - once the bank had declined to pay a transaction because of insufficient funds, the merchant controlled the number and timing of representment; and
    - the bank determined whether it paid or declined the represented transaction, and whether it assessed an NSF fee on the represented transaction.
- NSF fees on represented transactions were retained by the bank and did not provide benefits to consumers or competition that outweighed the consumer harm.[1]

MANAGING RISKS

Examiners identified the following methods that institutions had effectively used to mitigate UDAP risk related to the assessment of fees on represented transactions:

- Institutions refrained from assessing an NSF fee on a represented transaction after the bank assessed an NSF fee on the transaction when it was initially presented for payment.
- Institutions that relied on a third party for their systems monitored the third party's system settings for compliance with applicable laws and regulations, including the prohibition on UDAPs. Examiners also found it helpful when institutions informed their Federal Reserve contact if a third party was unable to comply with their directions relating to representments.[2]
- Institutions took steps to ensure that the information provided to consumers about represented transactions was accurate and consistent with the bank's policy and any systems limitations.

This list is based on supervisory observations to date and does not impose any legal obligations on banks. Other methods may also assist banks in managing their UDAP risks.

Endnotes

1 Section 5(a) of the FTC Act (15 U.S.C. §45(a)) prohibits “unfair or deceptive acts or practices in or affecting commerce” and applies to all persons engaged in commerce, including banks. Under Section 5(a) of the FTC Act, a three-part test is used to determine whether an act or practice is unfair. See *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (March 11, 2004). First, the act or practice must cause or be likely to cause substantial injury to consumers. Second, the injury cannot be reasonably avoided by consumers. Finally, the consumer harm must not be outweighed by countervailing benefits to consumers or competition. Multiple federal financial regulatory agencies have issued public statements addressing the risks of unfair or deceptive acts or practices related to assessing fees on representment transactions, including the OCC, *Overdraft Protection Programs: Risk Management Practices* (April 2023); the CFPB, *Supervisory Highlights Junk Fee Special Edition* (March 2023); and the FDIC, *Consumer Compliance Supervisory Highlights* (March 2022).

2 “Whether activities are performed internally or via a third party, banking organizations are required to operate in a safe and sound manner and in compliance with applicable laws and regulations. A banking organization’s use of third parties does not diminish its responsibility to meet these requirements to the same extent as if its activities were performed by the banking organization in-house.” *Interagency Guidance on Third-Party Relationships: Risk Management* (June 7, 2023).