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**UCC MATERIAL  
FOR YOUR INFORMATION**

RE: "Discretionary" Automatic Overdraft Privilege, Revised Letter

Dear \_\_\_\_\_ :

Laura E. Udis, Administrator, Uniform Consumer Credit Code, previously referred to me for response your letter to her of December 14, 2000. By letter dated February 23, 2001, I responded to your letter. This letter revises and supersedes my February 23 letter, which is hereby withdrawn.

In your December 14 letter, you asked the Administrator to opine whether your client's, an unidentified bank, automatic overdraft privilege program (program) is subject to the Uniform Consumer Credit Code, §§ 5-1-101, et seq., C.R.S. 2000 (Code). I have reviewed your letter, the materials you provided therewith, and your letter of February 12, 2001, which provided certain additional information in answer to my request in my letter to you of January 29, 2001.

Essentially, your client proposes to offer to its account holders an overdraft protection privilege by which your client will honor a customer's check, even though that check will overdraw the customer's account. According to your client's materials, this program will be offered only to those customers who are in "good standing". This is defined as:

A) Making regular deposits; B) Bringing the account to a positive balance at least once every thirty days or less; and C) There are no legal orders outstanding.

Your client's materials state that the program is a non-contractual courtesy and discretionary; the bank may honor or refuse to honor any check at any time in its sole discretion. Finally, your client states it charges the customer the same "NSF"/overdraft fee it would charge whether or not the check is honored.

Whether this program is subject to the Code requires the answer to two questions: (1) is the honoring of an "NSF" check a "loan"; and (2) if so, is it a "consumer loan". I discuss these in turn.

The Code defines "loan" to include

- (I) The creation of debt by the lender's payment of . . . money . . . to a third party for the account of the consumer; . . . {and}
- (IV) The forbearance of debt arising from a loan . . .

Code § 5-1-301(25)(a). Further, "credit" is defined as "the right granted by a creditor to a consumer to defer payment of debt or to incur debt and defer its payment". Code § 5-1-301(16).

In my opinion, there is no question but that the honoring of an "NSF" check is the extension of credit and therefore a loan. See, e.g., Union Gold Mining Co. v. Rocky Mountain National Bank, 2 Colo. 248, 255 (1873)(overdraft of account is a loan); see generally 11 Am. Jur. 2d Banks and Financial Institutions § 937 (1997).

Accordingly, I turn to the second question, whether your client's transactions are "consumer loans". To be a "consumer loan", four elements must be met: (1) the consumer must be a natural person or individual; (2) the debt must be incurred for personal, family, or household purposes; (3) the principal must not exceed \$75,000.00; and (4) either a loan finance charge is made or the debt is payable in installments. See Code § 5-1-301(15)(a).

Here, elements 1 through 3 appear met: (1) according to your client's materials, the program is for personal checking account holders; (2) similarly, your client limits the program to "consumer checking accounts . . . for personal and household use"; and (3) it also limits overdrafts in any one account to no more than \$500.00 outstanding at any one time.

As to element (4), Code § 5-1-301(20)(a) defines "finance charge" to mean

The sum of all charges payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit . . .

Because your client's "NSF" fee is charged as "an incident to" its extension of credit, it would be a "finance charge". However, federal Regulation Z § 226.4(a) excludes from the definition of "finance charge" those charges "of a type payable in a comparable cash transaction". Accordingly, so long as the "NSF" fee your client charges is the same whether or not the check is honored, this fee would not be a finance charge under the first test in element 4. Conversely, if the fee charged for honoring the check is greater than the standard "NSF" fee, that would be a finance charge.

However, the information you provided is insufficient for me to determine whether your client's program meets the "payable in installment" test of element 4. The Code incorporates a "four installment" rule, meaning that so long as the debt is repaid in four or fewer installments, it is not considered "payable in installments". See Code § 5-1-301(32).

Here, to be in good standing, your client requires that the customer make sufficient deposits to bring the account to a positive balance, i.e., repay the overdraft, within 30 days. Because, as stated in your February 12 letter, there are no specifics as to how that repayment may be made, it is possible that a customer could make more than four deposits to bring the account to a positive balance. This would trigger the "four installment" rule threshold. Due to the uncertainty and lack of specificity regarding repayment of the overdraft, I am unable to provide a definitive opinion on whether your client's program avoids the "four installment" rule and thus does not involve "consumer loans" subject to the Code.

Accordingly, for this reason and because your client is not identified, this letter is not, nor may be construed as, an interpretation or response of the Administrator pursuant to Code § 5-6-104(4) so as to provide your client "safe harbor". However, this does express the Administrator's current enforcement policy regarding "discretionary" overdraft programs subject to the caveat expressed below.

Finally, I wish to make two observations regarding the program. In its marketing materials, your client states: "Write a check for more than is in the Bank – the check may be covered!" We find this very troubling, as it seems to encourage account holders to overdraw their accounts and incur "NSF" fees.

Second, in our February 14, 2001, telephone conversation, you confirmed that, by its program, your client is not offering a "product" but merely is advertising a policy. However, it is possible a consumer could be misled by your client's materials; a consumer reasonably could be led to expect that your client will honor an overdrawn check. I note others share these and similar concerns, see C. Cheatham, Oklahoma Banker, Legal Briefs at 13-14 (August 2000). As this commentator suggests, "discretionary" overdraft programs may not actually be "discretionary" and may trigger federal and state regulatory requirements, despite the banks' "discretionary" disclaimers. If these programs truly are not "discretionary", this could alter the Administrator's foregoing analysis.

Thank you for your attention to this matter. If you have any questions, please do not hesitate to call.

Sincerely yours,

FOR THE ADMINISTRATOR

**ORIGINAL SIGNED**

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