ABA Staff Analysis©: Economic Impact Payments and Overdrafts
March 2021

The American Rescue Plan Act of 2021, which was signed into law on March 11, 2021, provides that eligible consumers will receive an Economic Impact Payment (EIP) from the Department of the Treasury in the amount of $1,400. In the first week of this third round of EIPs, more than 90 million EIPs were directly deposited into the recipient's bank account, and 150,000 EIPs were provided by check, according to the Treasury Department. In the following week, 20 million electronic payments and 10 million mailed payments were made. We expect an estimated 140 million payment will be made during this EIP cycle. This round of EIPs follows two earlier rounds of EIPs authorized by the Coronavirus Aid, Relief, and Economic Security (CARES) Act enacted in March 2020 and the Consolidated Appropriations Act for 2021 enacted in December 2020.

When deposited into an overdrawn account, absent intervention, banks' systems automatically apply the EIP, like any deposit, to the negative balance. In effect, the EIP is used to repay ("offset" or "set-off") all or a portion of the overdraft. While federal law does not prohibit using EIPs to pay overdrafts, ABA encourages banks to avoid such offsets, if feasible. In addition, there may be reputational and regulatory risk in using EIPs to offset overdrafts, and some state laws may prohibit it. Banks that allow access to the EIP by provisionally crediting overdrawn accounts in the amount of the overdraft should ensure that customers understand that the provisional credit will be revoked.

This staff analysis describes those risks and steps that banks can take to minimize risk and avoid the potential for customer confusion.

Challenges to, and Benefits of, Avoiding Offsetting EIPs

Because EIPs were intended to provide financial relief to people impacted by COVID, many banks sought ways to avoid applying EIPs to overdrafts to ensure their customers have full access to the funds. However, there are operational challenges because, as noted above, banks' systems (and their vendor's systems) automatically apply new deposits to negative balances.

To avoid applying EIPs to overdrafts, the bank must first be able to identify EIPs deposited into overdrawn accounts. Second, the bank must find a "work-around" to ensure funds are available, notwithstanding the negative balance.

Some banks have been able to identify EIPs deposited into overdrawn accounts, though identification may be imperfect.[1] These banks then provisionally credit the overdrawn account in the amount of the overdraft, creating a positive balance in the amount of the EIP, which allows

[1] While ACH EIPs in the second round were coded as "federal benefits" in order to allow them to be identified in an automated fashion to prevent their garnishment, EIPs in the first and third rounds are not. This third round of ACH EIPs are identified as EIPs via the Company Entry Description Field. EIPs issued by check contain indicators embedded in the MICR line that the check is an EIP.

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the customer to withdraw the EIP funds. The bank later revokes the provisional credit (e.g., after 60 or 90 days) on the basis that the customer has withdrawn the EIP funds during the period. Some vendors are able to provide a solution to allow access to EIPs for overdrawn accounts, but others are unable to do so.

Using EIPs to cover overdrafts may create regulatory risk. Some states have taken steps to prohibit depository institutions from using EIPs to pay overdrafts, charged-off loan obligations, and fees owed to the institution. In its January 2021 "Supervisory Highlights-COVID-19 Prioritized Assessments," the Consumer Financial Protection Bureau noted those state laws, stating that an institution's "[f]ailure to properly identify, analyze, and, as applicable, comply with state actions [regarding set-offs] poses a risk that consumers might be deprived of the full use of government benefits," which also could result in violations of Federal consumer financial law.[2] In addition, the Bureau has expressed its concern that "some of those desperately needed funds will not reach consumers, and will instead be intercepted by financial institutions or debt collectors to cover overdrafts fees, past-due debts, or other liabilities."[3]

For those financial institutions that waive set-off rights to the EIP, customer confusion about the use and revocation of provisional credits may introduce risk. In the Supervisory Highlights, the Bureau observed that, in examining large institutions, it found institutions used a variety of methods to waive set-off rights, including "refunding fees that contributed to a consumer's account being overdrawn, permanently forgiving overdrawn account balances, and issuing checks to consumers with overdraft accounts for the full amount of their EIPs . . . ."[4] Most frequently, institutions waived set-off rights through issuance of provisional credits in the amount of the overdraft account balances.[5] The revocation of these credits at a later date could leave some customers with a negative account balance. This practice may confuse customers if not clearly disclosed. The Bureau noted that "examiners found risk when the institutions [that issued provisional credits] failed to clearly communicate to consumers how and when provisional credits would be revoked."[6] This risk was exacerbated if the institution "lacked a clear policy preventing assessment of an overdraft fee when the revocation of provisional credit resulted in a negative account balance."[7]

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[2] Bureau of Consumer Fin. Prot., Supervisory Highlights, COVID-19 Prioritized Assessments Special Edition, Issue 23, at 22 (Winter 2021), https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-23_2021-01.pdf [hereinafter, Supervisory Highlights].
[3] See Press Statement, Bureau of Consumer Fin. Prot., Consumer Financial Protection Bureau Encourages Financial Institutions and Debt Collectors to Allow Stimulus Payments to Reach Consumers (Mar. 17, 2021), https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-encourages-financial-institutions-and-debt-collectors-to-allow-stimulus-payments-to-reach-consumers/.
[4] Supervisory Highlights, *supra* note 2, at 22. If the bank permanently forgives an overdraft account balance, the customer may owe taxes on the amount forgiven.
[5] *Id.*
[6] *Id.*
[7] *Id.*

Potential Bank Actions to Avoid Risk

In light of the regulatory risk associated with offsetting EIPs to cover overdraft account balances, banks may wish to consider taking the following actions:

1. Work with the bank's IT system or, as applicable, vendor, to identify EIPs entering customers' accounts and avoid offsetting the amount of the EIP to cover an overdraft, through manual or automated "work-arounds" or other means. This is particularly important if the bank operates in a state that prohibits financial institutions from using EIPs to cover overdrafts.

2. If the bank waives set-off rights through issuance of a provisional credit in the amount of the overdraft account balance—and then later revokes the provisional credit—the bank should consider drafting a clear and conspicuous disclosure to explain when the provisional credit will be reversed and whether an overdraft fee would be assessed when the revocation results in a negative account balance.

Questions? Contact ABA's Jonathan Thessin or Nessa Feddis for more information.