The Right Overdraft Program Provider Does 'The Right Thing': No Incentive Compensation

Recently, the American Bankers Association sponsored an educational webinar called "Avoiding 'OOPS!' in Your Overdraft Protection Program." The program provided tips on how to successfully offer consumers a cost-effective service without encouraging reckless behavior by actively managing the legal, compliance, operations and reputation risk that accompanies overdraft protection (ODP) programs today.

The webinar offered many sound suggestions with regard to ad hoc decision-making, lines of credit, etc., but we found the section that related to third-party arrangements especially valuable. According to the presenter, Patti J. Blenden, CRCM, CPA, President, Financial Solutions for Growing Companies, Inc., overdraft programs managed by third-party providers have the potential to raise concerns that differ from in-house ODP solutions.

Specifically, Ms. Blenden warned that the practice by some third-party overdraft providers of pricing their overdraft programs based on a percentage of the increase in income the bank will generate is generally inconsistent with promoting the responsible use of these programs. You may have heard of this type of incentive compensation referred to as a percentage of "lift" or "pay for performance," which essentially rewards the provider with a percentage of the additional fee income generated by the program.

Unfortunately, many third-party providers today still price their programs based on this form of incentive compensation. However, when compliance examiners evaluate whether the third-party relationship raises the potential for compliance, operational, financial and reputational risks to the financial institution, they may look harshly on such an arrangement. Many a third-party provider in this type of an arrangement may encourage practices that boost revenue in the short term, but be detrimental to the customer and the bank in the long run. The preferred pricing methodology is to establish a fixed price for the service that is not tied to program performance.

Ms. Blenden made it very clear that neither an institution's third-party vendor nor its own internal infrastructure should incent the fee income that can be generated by the overdraft service. She drew a comparison to the loan originator compensation that led to mortgage reform restrictions: if we give people the incentive to make more money, they are going to come up with creative ways to do so and they may not be in the bank's long-term best interest.

She suggested that institutions not only look at their third-party overdraft arrangement and eliminate incentive compensation, but also at their own institution: Do you incent employees to get more people involved in the program? These activities can be an indicator to a regulator or to an independent reviewer that your institution is focusing on incentivizing employees or the third-party vendor at the expense of the consumer… exactly what you do not want.

Ms. Blenden's final word on the topic (and we couldn't agree more): "Make sure you're using the right people to do the right thing."

To learn more about the responsible approach to managing overdrafts, *please contact BSG Financial Group at (866) 274-8900 or go to http://www.bsgfinancial.com/ResponsibleApproach.*

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