# Department of Law
# State of Georgia

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## OFFICIAL OPINION 2003-9

**To:** Commissioner
Department of Banking and Finance

August 12, 2003

**Re:** An overdraft fee will not be considered interest when the transaction is readily characterized as a checking account transaction, lacking the legal and economic reality of a loan or extension of credit, and when the fee is not determined based on the amount and time value of overdraft amounts.

You have requested my official opinion concerning various programs offered by financial institutions to provide overdraft protection to customers. Referring to several factual scenarios, you ask whether each situation will be governed by the Financial Institutions Code of Georgia, O.C.G.A. §§ 7 1 1 to 1021 (1997 and Supp. 2002) (the "Banking Law"), regarding deposit accounts and the fees associated with those accounts or by Georgia's general usury laws. In other words, you have asked whether the fees described are "interest."

Under Georgia law, if the overdraft fees are "interest" Georgia usury laws apply. If the overdraft fees are not "interest" the Banking Law applies. *See* 1985 Op. Att'y Gen. 85-32 (the Lender Credit Card Act (now "The Credit Card and Credit Card Bank Act"), and not Georgia general usury law, applies to **overdraft plans** that involve extensions of credit).

Before turning to your specific questions, it is useful to review some of the same general legal principles that were addressed in 2003 Op. Att'y Gen. 03-8 in response to one of a series of related questions you have asked. I recognize that this retraces the legal review contained in that opinion, but for the sake of clarity and ease of reference it bears repeating in the context of this opinion.

Georgia's general usury law provides a statutory definition of "interest":

As used in this Code section, the term "interest" means a charge for the use of money computed over the term of the contract at the rate stated in the contract or precomputed at a stated rate on the scheduled principal balance or computed in any other way or any other form. Principal includes such charges to which the parties may agree under paragraph (1) of this subsection. Amounts paid or contracted to be paid as either an origination fee or discount points, or both, on any loan secured by an interest in real estate shall not be considered interest and shall not be taken into consideration in the calculation of interest and shall not be subject to rebate as provided in paragraph (1) of subsection (b) of this Code section.

O.C.G.A. § 7 4 2(a)(3). Implicit in the phrase "the use of money" is the notion that an extension of credit is occurring. In other words, money is being loaned. If money is being loaned, then the determination must be made whether "interest" is being charged. Implicit in the phrase "computed over the term of the contract at the rate stated in the contract or precomputed at a stated rate on the scheduled principal balance or computed in any other way or any other form" is the idea that, in order to be "interest" under the definition cited above, the arrangement must involve some form of "time value of money" calculation.[1]

Therefore, a transaction that involves an extension of credit and a charge that is based on a time value of money calculation generally will fall under the usury statute unless a statutory exception exists. A charge that is not truly based on a "time value of money" calculation will not, then, be "interest," provided that the lender is actually providing a service for which the charge is assessed and provided that the charge bears a reasonable relationship to the cost of providing the service. These provisos have their origin in decisions of the appellate courts of Georgia. The Supreme Court of Georgia "has uniformly and consistently held that a lender's charge for service, when no service was in fact rendered or to be rendered the borrower, is a charge for the use of the money advanced and is therefore interest." *First Fed. Sav. & Loan Ass'n v. Norwood Realty Co.*, 212 Ga. 524, 531 (1956). *See also Williams v. First Bank & Trust Co.*, 154 Ga. App. 879 (1980) ("service charge" constituted interest where there was no evidence that the bank performed any service in return for the fee and where one of the bank officers testified that he did not know what the fee was for).[2] Thus, if a particular fee is "interest" because there is no factual justification for its imposition, it must be considered cumulatively with whatever stated interest is being charged, using the controlling "time value of money" formula to determine the actual effective rate of interest. *See generally* 2003 Op. Att'y Gen. 03-8.

Whether a particular overdraft protection plan involves the extension of credit and the charging of interest is a fact-intensive review, and each situation must be considered on a case-by-case basis. Your request describes three basic overdraft programs, each modified by the same three variations in establishing overdraft thresholds, followed by a final proviso modifying the assumptions underlying each of the foregoing overdraft program descriptions. I will address each individually with the understanding that these scenarios are not an exclusive list of all the possible structures of an overdraft protection plan. I turn now to the specific factual situations you have presented to me.

*1. An overdraft program provides that the bank may honor checks presented against an account notwithstanding insufficient funds, provided, however, that the bank is never obligated to honor these checks and could, instead, return them unpaid. Under the program, the bank charges a flat fee per item, and this fee is the same whether a check is honored or is returned unpaid. The depositor is required by the terms of the governing deposit agreement to repay each honored overdraft and related overdraft fee immediately, without demand or notice.*

*Variant (a) In addition, assume that the program also provides that the bank determines whether it will pay or return the check based on an "overdraft threshold" that it establishes for each depositor and that this overdraft threshold is the same for each depositor.*

*Variant (b) In addition, assume that the program also provides that the bank establishes a different overdraft threshold for each customer based on the customer's monthly check volume, so that customers who routinely write large numbers of checks or large dollar amount checks have a larger overdraft limit than those customers who typically write a small number or dollar amount of checks each month.*

*Variant (c) In addition, assume that the program also provides that the bank establishes a different overdraft threshold for each customer based on a review of that customer's check repayment history.*

Assuming that the bank has a reasonable factual justification for the imposition of the fee in hypothetical 1, the fee charged under this overdraft program is not "interest" because its determination does not involve a "time value of money" calculation. Likewise, and again assuming that the bank has a reasonable factual justification for the imposition of the fee, the fee charged in variants 1(a), 1(b), and 1(c) is not "interest" because its determination does not involve a "time value of money" calculation. So long as the overdraft threshold is not determined based on the amount *and* time value of overdraft amounts, the overdraft threshold is irrelevant to the determination of whether an overdraft fee is "interest."

*2. Assume that the facts are as set forth in item 1, except that the overdraft program also provides that the bank charges a higher overdraft fee to honor the check than to return it unpaid. (Consider this program also as modified in each of the different threshold determinations described in variants (a), (b), and (c) above.)*

The fee charged under the assumed facts of hypothetical 2 and threshold variants 2(a), 2(b), and 2(c) does not appear to be "interest" because its determination does not involve a "time value of money" calculation. The differentiation in the level of fee would have to be reviewed more closely than the facts presented will allow, and a

determination would have to be made whether the bank has a factual justification for the differentiation in the fee amounts (*e.g.*, higher costs to the bank in processing an overdraft than in returning the check for insufficient funds). So long as the overdraft threshold is not determined based on the amount *and* time value of overdraft amounts, the overdraft threshold is irrelevant to the determination of whether an overdraft fee is "interest."

*3. The facts are as set forth in item 1, except that the overdraft program also provides that the bank charges a daily fee for each day that an honored overdraft item remains unreimbursed to the bank by the consumer. (Consider this program also as modified in each of the different threshold determinations described in variants (a), (b), and (c) above.)*

At first consideration, the fee charged under the assumed facts of hypothetical 3 and threshold variants 3(a), 3(b), and 3(c) does appear to be a simple "time value of money" calculation. If so, the imposition of the fee would constitute the imposition of "interest" and the Georgia general usury laws would apply to transactions in which such a fee were charged. However, it may be possible for the bank to demonstrate that the daily fee is economically equivalent to the flat fee charged and actual costs covered as posited in hypothetical 1 and its corresponding response above. So long as the overdraft threshold is not determined based on the amount *and* time value of overdraft amounts, the overdraft threshold is irrelevant to the determination of whether an overdraft fee is "interest."

*4. The program is as described in any of the factual scenarios set forth above with the additional provision that the bank is obligated by written agreement to honor (pay) overdraft items on behalf of the customer up to a prescribed limit.*

The bank's obligation to pay the overdraft as contemplated in hypothetical 4 is significant. In each of the preceding transactions, the assumption is that the bank *may* honor checks presented against an account notwithstanding insufficient funds, that the bank is *never obligated* to honor the checks and could return them unpaid, and that the depositor is required by the terms of the governing deposit agreement to repay each honored overdraft and related overdraft fee immediately without demand or notice.

The additional assumption of hypothetical 4 makes it more difficult to characterize the transaction as a checking account transaction as opposed to an extension of credit or a loan. *See Video Trax, Inc. v. NationsBank*, 33 F. Supp.2d 1041, 1053-54 (S.D. Fla. 1998) (distinguishing the concepts). In hypothetical 4, the bank *must* pay the draft from *its* funds. However, the facts of this scenario do not include other facts that may have significance, such as whether the depositor is required by agreement to repay immediately both the overdraft and the overdraft fee or whether, in the reality of the transaction or by agreement, a certain period of grace routinely follows. It remains pertinent whether any fee is determined based on the amount *and* time value of overdrafted amounts.

Therefore, under the general facts set forth above, it is my official opinion that an overdraft fee will not be considered interest when the transaction is readily characterized as a checking account transaction, lacking the legal and economic reality of a loan or extension of credit, and when the fee is not determined based on the amount and time value of overdraft amounts.[3] *See generally Video Trax, Inc. v. NationsBank*, 33 F. Supp. 2d 1041, 1053-54 (S.D. Fla. 1998); *First Bank v. Tony's Tortilla Factory, Inc.*, 877 S.W.2d 285 (Tex. 1994); *Bernstein v. Alpha Assoc. (In re Frigitemp Corp.)*, 34 B.R. 1000 (Bankr. S.D.N.Y. 1983).[4]

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[1] A "time value of money" formula involving simple interest for a loan of one year or more can be stated as: Effective $rate_{simple}$ = Stated (or nominal) rate ÷ Principal Amount of Loan. A "time value of money" formula for a loan involving compound interest can be stated as: $FVn = PV(1+(k_{nom} \div m))^{mn}$, where FV = future value, n = number of years, m = number of times per year compounding occurs, PV = present value, and $k_{nom}$ = stated (or

nominal) interest rate. This formula, as well as others of a similar nature, is contemplated under a plain reading of the Code section.

[2] This situation is to be distinguished from transactions in which the lender introduces some consideration, token in nature or undesired by the borrower, for the purpose of disguising interest and circumventing usury laws. *See Tribble v. State*, 89 Ga. App. 593, 596-97 (1954); 2002 Op. Att'y Gen. 02-3.

[3] Please keep in mind that these analyses are very fact specific and that the responses contained in this opinion are confined to the general facts presented in your questions. The characterization of specific programs will require expertise in banking and access to detailed information such as you and your staff have. Indeed, the information necessary for the characterization of such programs may be beyond the reach of the ordinary checking account customer. *See Video Trax, Inc. v. NationsBank*, 33 F. Supp. 2d 1041, 1051 n.5. Note further that this opinion is confined to an analysis of state law only.

[4] *Bernstein v. Alpha Associates* held a bank not subject to an adversary action for preferential treatment after honoring an overdraft and exercising setoff rights. The court recognized that "[t]he overdraft has proved to have enormous significance as a credit device" before it concluded that "[c]ompelling reasons exist, however, for protecting the established right of banks to set off deposits against overdrafts. The widespread, systematic use of overdrafts as a credit mechanism may be a recent development, but the overdraft has long been used as an adjunct to payment and collection services." *Id.* at 1019, 1020. The court also noted that the Uniform Commercial Code provides specifically for overdraft payment. *Id.* at 1020. *Accord* O.C.G.A. § 11 4 401(a)(2002): "A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft."