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DEBIT CARD OVERDRAFT FEES

Reforms Welcomed but More are Necessary

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Introduction

Bank overdraft fees take an enormous toll on American consumers, especially those with low balances or those new to banking. Over 50 million Americans overdrew their checking account at least once over a 12 month period, paying a total of \$23.7 billion in overdraft fees in 2009. [1] Over half of those consumers incurred five or more overdraft or non-sufficient funds (NSF) fees in the course of a year. [2]

These fees fall disproportionately on a small proportion of bank customers, concentrated in low-income communities and communities of color. Those who can least afford to pay these fees bear an excessive share of the burden. A survey of overdraft users in 2006 found that sixteen percent of overdraft users account for 71% of all overdraft fees. People who repeatedly incurred overdraft fees were also found to be significantly more likely to be low-income, single, and people of color. [3] (See Figures 2 and 3.)

Fees often seem considerably out of proportion, with a \$5 purchase commonly incurring a fee of \$25 or more. Many major banks use a gimmick called “re-ordering charges” to maximize the fees they collect. Instead of processing a consumer’s transactions in the order they occur, these banks re-order

the purchases so that the most expensive is counted first, thereby increasing the likelihood that a consumer will overdraw his or her account and increasing the number of overdrafts.

For example, consider a consumer with \$50 in her account who makes a debit card purchase of \$10 at 10 a.m., a \$7.50 purchase at noon the same day, and a \$55 purchase at 3 p.m. If the transactions were processed in the order they occurred, only the final purchase would generate an overdraft fee. Reordering allows the bank to process the \$55 purchase first and charge three overdraft fees, one for each transaction that day.

As a result of the fee structures, *the average borrower ends up being charged \$1.94 for every \$1 that they borrow on overdraft by a debit card purchase.* [4]

Banks regularly emphasize the importance of putting customers first. Indeed, that is how it should be. But for customers, the reality often feels far too much like a punitive experience. Evidence suggests that excessive and confusing fees discourage many, especially lower-income Americans, from using banks, and instead drive them to services such as check-cashing businesses and payday lenders whose practices are often worse.



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FIGURE 1: Effect of Reordering of Charges on Account Balance

Without Reordering			With Reordering		
	Charges	Account Balance		Charges	Account Balance
Starting Balance		\$50.00	Starting Balance		\$50.00
10:00am	\$10.00	\$40.00	3:00pm	\$55.00	(\$5.00)
12:00pm	\$7.50	\$32.50	10:00am	\$10.00	(\$15.00)
3:00pm	\$55.00	(\$22.50)	12:00pm	\$7.50	(\$22.50)
Without reordering, only the last charge results in an overdraft, so bank charges customer only one overdraft fee.			If the bank reorders the day's charges, they process the largest one first, resulting in three overdraft occurrences.		

Findings

Excessive and confusing bank overdraft fees, particularly as applied to ATM and debit cards, are a major problem for consumers. In 2009, Americans paid \$23.7 billion in overdraft fees – fees that are often poorly explained or not clearly disclosed, leading to customer confusion. Fears of hidden fees may be a significant reason why millions of Americans do without bank accounts.

In many cases, banks maximize these fees through the practice of “reordering charges” – rearranging the order in which transactions are processed in order to maximize the number of overdraft occurrences.

In response to these complaints, the Federal Reserve Board enacted Regulation E, taking effect July 1, 2010, which bars banks from charging overdraft fees unless the customer “opts-in,” affirmatively choosing to have overdraft protection. Banks must also provide a notice that clearly explains the institution’s overdraft services.

The Greenlining Institute’s analysis of bank overdraft fees and policies shows that Regulation E, while an important reform, is insufficient to solve the problem presented by excessive and confusing fees. Some banks appear to be trying to frighten customers out of opting out, and many bank employees we spoke to were confused about their own bank’s overdraft policies.

Further reforms are needed, including limits on the number or amount of fees charged, a complete end to reordering of charges, establishment of common metrics to allow consumers to easily compare overdraft policies between institutions, and establishment of a system under

which a customer can obtain overdraft protection for only selected, high-priority transactions, such as rent, mortgage payments, and/or utility bills.

Voluntary Changes to Overdraft Policies

In response to deep public dissatisfaction with the banking industry, many major banks have enacted consumer-friendly changes to their overdraft fee policies. **Bank of America** recently announced that it would end their overdraft program for any purchases made with a debit card. In other words, any debit card purchase initiated without sufficient money in an account will simply be declined.

In addition, consumers will be unable to overdraw from an ATM unless they agree to the \$35 fee prior to withdrawal. A few banks, such as **JP Morgan Chase**, announced that they would stop re-ordering fees on ATM and debit card purchases. Some banks have also raised the minimum amount that one must be overdrawn in a given day before an overdraft fee is charged. This minimum amount represents the minimum amount of money that must be overdrawn from the account in order to incur a fee. However, the highest minimum amount among the banks in this study is \$10, which is still out of proportion with the \$35 overdraft fee that any overdraft above that amount can incur. For banks without an overdraft minimum, even a charge as small as 25 cents can incur the full overdraft fee.

Regulation E and a Requirement to “Opt-In”

Regulation E requires financial institutions to obtain customer consent (an “opt-in”) for overdraft protection before the institution is allowed to collect overdraft fees on one-time debit card transaction or ATM withdrawals. The

regulation also bars financial institutions from discriminating against consumers who choose not to opt-in to overdraft protection, stating that they must be provided “the same account terms, conditions, and features (including pricing)” as those who do opt-in. [5]

Prior to opting in, Regulation E requires that all consumers be provided with a notice that clearly explains the financial institution's overdraft services, including fees associated with the service, and the options available. All financial institutions must comply with this regulation by July 1, 2010 for new customers and August 15, 2010 for existing customers.

While these are helpful changes, significant concerns remain. Overdraft fees are still too high for many low-income consumers, and the policies themselves often remain confusing and difficult to understand, so that even with the newly required disclosures, consumers might still fall into the trap of unnecessarily accumulating overdraft charges.

Conclusion

Despite positive changes, on average, overdraft fees are still too high. With fees of \$25 or more being charged for purchases as low as \$5, a customer can still easily run up fees of well over \$100 in a single day.

Banks claim that assessing fees is part of their efforts to keep up with the rising cost of doing business, yet such fees discourage a significant number of customers from initiating a relationship with the bank. Therefore, by sacrificing fee revenue in the short run, banks may be able to recapture some market share from payday lenders, leading to greater profits in the long term.

Additional observations include the following:

Fees Are Difficult to Understand

Our research identified numerous barriers to transparency and clarity for consumers. First, different policies and fees apply to different types of accounts, with so many variations between institutions that direct comparisons are difficult. Second, fee structures are changing frequently, both as a result of consumer backlash and upcoming regulatory changes. Because of these shifts, a number of bank representatives we contacted admitted that they did not know their bank’s current overdraft policy, given how quickly they are changing.

Misleading Information Discourages Consumer Choice

Recent news reports indicate that some financial institutions are already finding ways to discourage customers from opting out of overdraft protection. For example, the *New York Times* reported that at least one

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FIGURE 2: People of Color are More Likely to be Unbanked [6]

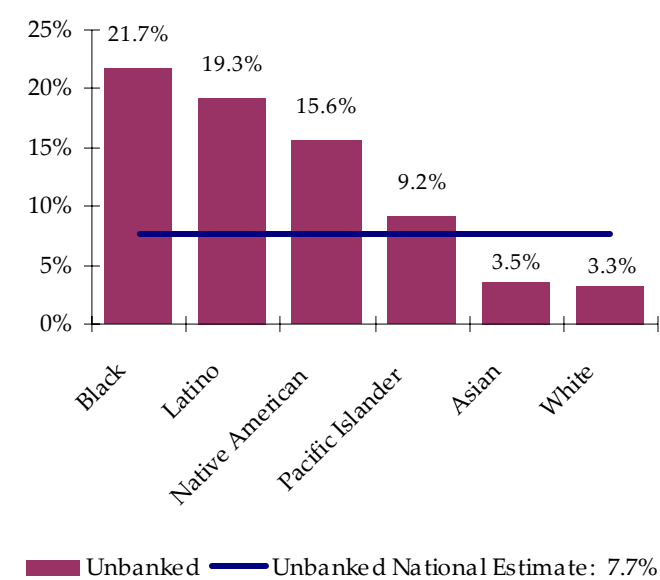
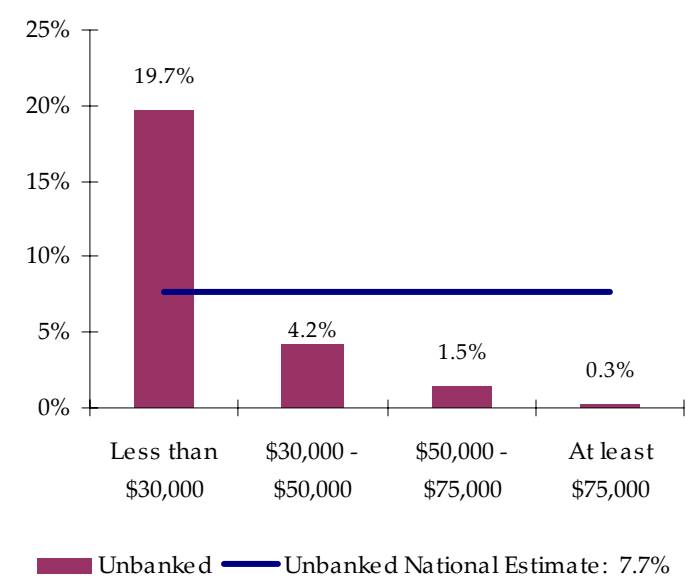


FIGURE 3: Lower-Income People are More Likely to be Unbanked [7]



Bank	Overdraft Fee Without Protection	Overdraft Protection Transfer Fee	Maximum Amount of Overdraft Fees Per Day
Bank of America	Bank of America will end overdraft fees on debit card purchases as of summer 2010		
JP Morgan Chase	\$34	\$10 (Can be linked to savings, credit card, or home equity line of credit)	3
Wells Fargo	\$25 for the first overdraft in a 12 month period, \$35 for the second and all additional overdraft occasions	\$10	4
US Bank	\$19 per item on the first occasion*, \$35 per item for occasion two to four, and \$37.50 per item for 5 or more occasions	\$5 per item covered	3
Citibank	Citibank does not charge overdraft fees on debit card purchases.		
Bank of the West	\$26 for the first occurrence of an overdraft being paid or returned by the bank, \$35 for each additional occurrence	\$10	4
Comerica (Western Market)	\$25 for the first occurrence \$33 for the second, third, and fourth occurrences, \$37 for the 5 th or greater occurrence in a 12 month period	\$7 for the first to fourth occurrences, \$12 for the fifth to seventh occurrences, and \$16 for the 8 th or greater occurrence	5
Union Bank	\$22 per item returned or paid for the first two occurrences, \$30 for occurrences 3-5, and \$34 for 6 or more occurrences	\$10 each day that a transfer occurs	5

Additional Overdraft Related Fees	Minimum Overdraft Amount in Order to be Charged Fees	Annual Overdraft Limit	Ability to Opt out of Debit Overdraft	Bank
Bank of America will end overdraft fees on debit card purchases as of summer 2010				Bank of America
Additional \$15 if an account is overdrafted for 5 or more consecutive business days	\$5	None	Yes	JP Morgan Chase
\$5 per business day after account has been continuously overdrafted, starting on the 4 th business day. Charges continue through the 11 th calendar day of continuous overdraft	Over \$5	None	Customers will automatically be opted out later this year and customers will be allowed to then opt-in	Wells Fargo
After 3 days of continuous overdraft the account is charged \$8 until the account is paid in full	\$10	None	Yes	US Bank
Citibank does not charge overdraft fees on debit card purchases.				Citibank
Beginning on the third business day following the day on which the overdraft occurred, overdrafted balances of \$15.00 or more may be assessed \$5 each business day.	\$5	None	Yes	Bank of the West
\$6 a day starting on the 5 th business day that the account is overdrafted and continues for 5 consecutive business days or until the account is brought into a positive balance, whichever comes first	None	None	Yes	Comerica (Western Market)
\$6 per business day, starting on the 7 th calendar day of overdraft condition. \$30 maximum for this fee.	\$5	None	No	Union Bank

bank is sending letters to consumers carrying a disturbing warning that, “Your debit card may not work the same way anymore, even if you just made a deposit.” The warning continues in large red type, “If you don’t contact us, your everyday debit card transactions that overdraw your account will not be authorized after August 15, 2010 — *even in an emergency*” (emphasis in original). [8]

Banks have a responsibility to clearly communicate changes in overdraft policies and how they will affect consumers, but such disclosures should not be written in a sensationalized manner that seeks to frighten consumers.

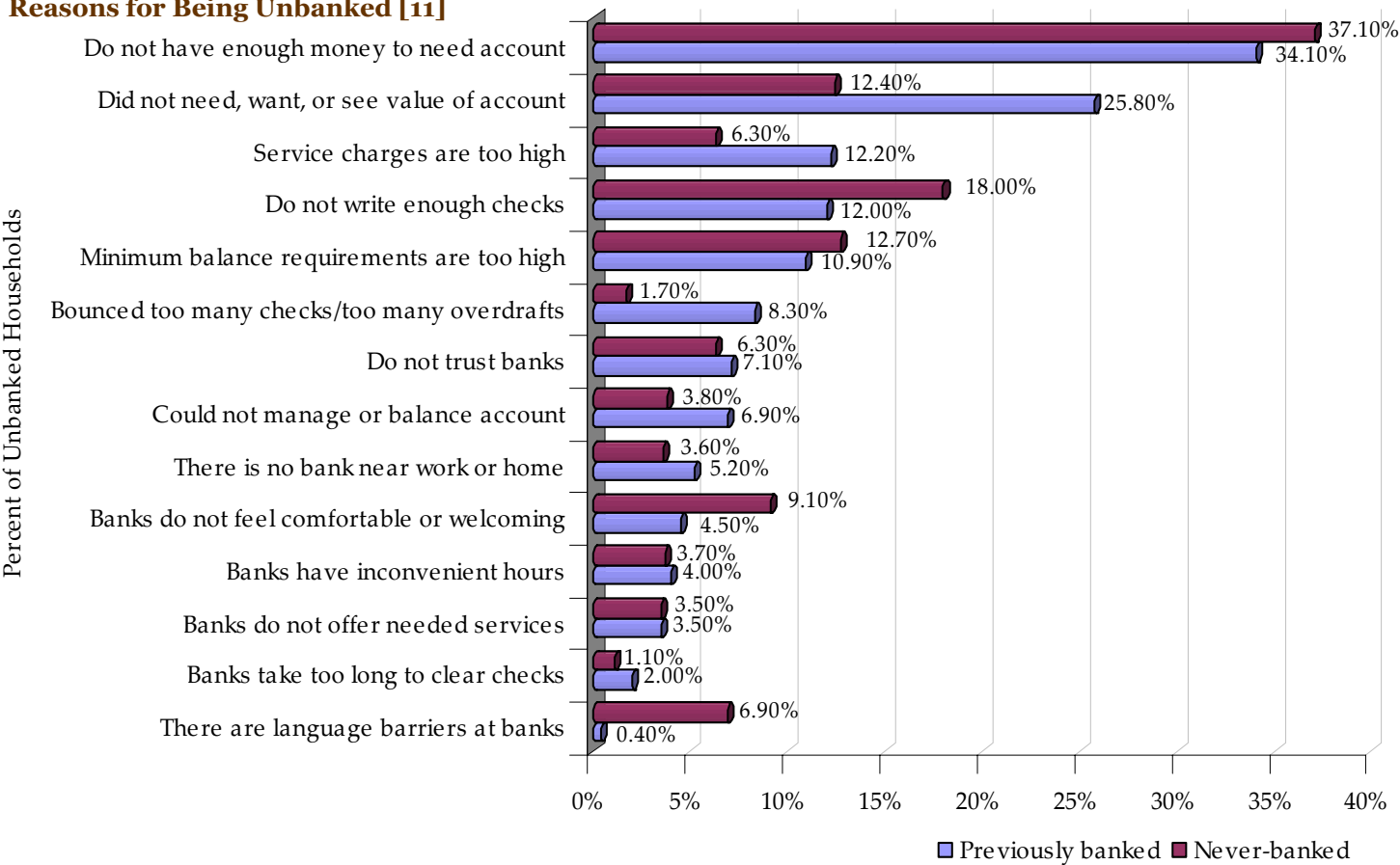
Not surprisingly, opportunistic marketing firms have been peddling services to the banks that promise to craft a marketing campaign that aims to “maximize fee revenue” and “minimize attrition” by tricking unwary consumers into opting in to “overdraft protection.” [9]

Recommendations

The problems created by confusing and excessive overdraft fees extend beyond some customers being hit with excessive charges. Surveys of customers who have bank accounts, but still use check cashing services and payday lenders, clearly show strong distrust of major banks among consumers. High overdraft fees that are hard to understand and the fear of being punished with unexpected charges create a significant disincentive to use bank services. Consumers may end up paying even higher fees at alternative institutions, while banks lose potential life-long customers.

Research by the Federal Reserve Board demonstrates that while most consumers do not want overdraft protection, they do express a preference for using their overdraft protection to cover only important bills, such as checks and automatic payments they use to pay rent, utilities, and telephone bills. [10]

Reasons for Being Unbanked [11]



In light of these findings, the Greenlining Institute recommends that all banks follow the **Bank of America** model and eliminate overdraft fees on all debit card purchases. In order to continue improving overdraft policies so that they are both fair and helpful to ordinary consumers, we propose the following changes:

Fewer Fees

Banks can substantially reduce the burden of overdraft fees on their consumers. In order to accomplish this, they should:

- Eliminate the practice of reordering charges.
- Charge only one fee per day and limiting to six the number of times per year an overdraft fee can be charged.
- “Forgive” the first overdraft on an account
- Charge fees that are proportional to the amount overdrawn. In that vein, banks should not assess fees until an account is at least \$100 overdrawn.
- Provide customers the option of linking one’s savings account to one’s checking account, allowing a low-cost shifting of funds from one account to the other

Clarity

Without clearly explaining and posting overdraft policies, customers will not be able to benefit from the positive changes enacted. In order to ensure that all customers are fully aware of the overdraft policies at each bank, we propose that:

- Fee structures should be posted in a manner that is clear and easy to understand
- Banks should establish common metrics for overdraft policies to allow for easy comparisons between competing institutions and types of accounts
- Banks with substantial non-English-speaking clientele should provide in-language information about their fee structures.

Regulatory Improvements

While we hope that banks will make the changes outlined above voluntarily, we would urge the Federal Reserve to require such actions if they are not widely adopted on a voluntary basis.

Glossary of Terms

Occurrence

Incident in which an account holder overdraws on their account. Multiple overdraft fees can be assessed in one occurrence and banks often assess the fee based on the number of incidents within a 12 month period.

Continuous Overdraft

Number of consecutive days that an account remains overdrawn.

Overdraft Fee without Protection

Fees charged for checking account holders that do not have their account linked to a savings account or line of credit

Overdraft Protection Transfer Fee

Fee for transferring money from a savings account or line of credit in order to cover an overdraft.

Maximum amount of Fees Per Day

Maximum amount an account holder can be charged per day for overdrafts.

Additional Overdraft Related Fees

Fees that are charged in addition to overdraft fees when an account holder overdraws their account. Often these occur if the account holder does not correct the overdraft and bring their balance above \$0 within a set number of days.

Minimum Overdraft Amount in Order to be Charged Fees

Maximum amount that an account holder is allowed to overdraw without being charged fees.

Annual Overdraft Limit

The maximum amount an account holder can be charged a year in overdraft fees.

Ability to Opt Out of Debit Overdraft

The ability of an account holder to choose whether or not their debit card can be approved for money that is not currently available.

Methodology

Greenlining surveyed the overdraft fee policies of the major financial institutions in California. Data was collected by the following measures:

- Internet searches
- Phone calls to bank customer service representatives
- Interviews with bank representatives at local branches
- Reviews of promotional information received from bank branches

checking account offered by each bank. After assembling information from the sources above, we contacted representatives of each bank and asked them to confirm the data we received and correct any errors.

The summary on pages 4-5 reflects those corrections. Some banks reported back with upcoming changes to their overdraft policies, and the current grid reflects those changes as well.

To create a simple, baseline comparison, we chose to only assess fees for the most basic

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