Overdraft Loans Trap Borrowers in Debt:

Unfair bank practices artificially increase fees

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OVERDRAFT LOAN = HIGH-COST NO-CHOICE CREDIT

Protection? More like small loans with abusive terms.

Banks and credit unions now enroll many of their account holders into the most expensive option for covering overdrafts—an option customers generally don't want and didn't ask for—and leave them without the information they need to protect their funds. Under these systems, financial institutions routinely approve uncovered transactions without warning their customers of a deficit in their accounts, and charge an average $34 fee for each incident, even when the uncovered purchase amounts to just a few dollars.

Overdraft loans often hurt, rather than help

A customer who reads the fine print after setting up a bank account may find that she has been automatically enrolled in the bank's "overdraft protection" program.

Sounds like a service, but today's overdraft programs reward the banker, not the customer. Overdrafts are paid, but banks can manipulate their systems so that the fees they charge for those overdrafts are maximized. Many customers get trapped in the red.

Fees vastly outweigh shortfalls

Almost half of all overdrafts (46%) are triggered by debit cards at the ATM or the point of sale. These overdrafts could be easily prevented with a warning or denial. Most debit point-of-sale overdrafts are small, averaging less than half this $34 fee, meaning that these overdraft loans cost nearly $2 for every dollar advanced to cover the shortfall.

Unfair practices

Unfair practices include holding deposits longer than necessary and clearing daily transactions from the highest to the lowest, which often allows the bank to charge more fees than are warranted. Banks and credit unions are collecting $17.5 billion per year in abusive overdraft fees, higher even than the $15.8 billion extended in funds to cover the overdrafts.

As banks increasingly rely on this source of income, they are penalizing customers in new ways, like charging for each day an account stays in the red. The fees come disproportionately from low- and middle-income Americans.

Lenders avoid disclosing interest rates

Because of a loophole in federal regulations, banks do not have to disclose the annual interest rate of an overdraft loan to their customers. This means that customers are denied the ability to comparison shop based on the true cost of credit.

FAST FACTS ABOUT OVERDRAFT LOANS

- Overdraft and NSF fees have become the lead driver of service fee income for banks, accounting for more than 45 percent of service fee revenue for some banks, and steadily rising. In 2003, a majority of the 331 banks surveyed by the American Bankers Association named overdraft lending as their most profitable service after residential mortgages.

- It is becoming easier to overdraft than ever before, especially as more and more banks change their policy from rejecting debit cards purchases that cause overdrafts to using debit card overdrafts to generate fees. Debit card use in has jumped 20 percent a year since 1996 and eclipsed check use. From 2001 to 2003, consumers made 42.5 billion debit card transactions. A CRL survey of 5,000 accountholders found that debit purchases as the single largest cause of overdrafts.

- Traditionally, banks covered occasional overdrafts for some customers on a discretionary basis. Today, nine out of 10 banks use overdraft software packages that systematically pay overdrafts, with no assessment of their customers' ability to repay the loan. From 2003 to 2005, the number of financial institutions using vendor-based automated overdraft loan programs grew 80 percent, for a total of some 3,500 institutions.

- Banks that use typical guidelines for automated overdraft programs—account opened for at least 30 days, account holder not in default to the bank, regular deposit activity—are expected to increase the number of overdrafts by as much as 200 percent, with some overdraft software vendors promising as much as a 400 percent gain. The vendors get paid based on the increase in overdraft revenues.

- While automation has reduced the cost of overdraft lending, average overdraft fees increased 24 percent from 1998 to 2006. By 2007, Americans were paying $17.5 billion per year in fees for abusive overdraft loans.

- Young adults are paying $1 billion per year in fees for abusive overdraft loans, nearly $3 for every dollar borrowed for debit card overdrafts. Universities contribute to this problem by granting exclusive marketing privileges to banks that engage in abusive overdraft practices.

- Sixteen percent of overdraft loan users account for 71 percent of fee-based overdraft loan fees. Repeat users are more often low-income, single, non-white renters. For these consumers, overdraft loans become an extremely expensive substitute for a line of credit, and they are paying fees that can be as costly as payday loans.

About the Center for Responsible Lending

The Center for Responsible Lending is dedicated to protecting home ownership and family wealth by working to eliminate abusive financial practices. CRL is a national nonprofit, nonpartisan research and policy organization that promotes responsible lending practices and access to fair terms of credit for low-wealth families.

For additional information, please visit our website at **www.responsiblelending.org**.