Out of Balance

Consumers pay $17.5 billion per year in fees for abusive overdraft loans

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EXECUTIVE SUMMARY

Today's most common overdraft systems are designed to generate more overdrafts from customers, resulting in enormous fee revenues for banks and credit unions. These systems use a mechanism that makes small, unsolicited loans to checking account holders whose balances are in the negative, collecting high fees for each transaction and often sinking them even deeper into the red. The problem is especially pressing because although these systems are costly for all consumers, financially distressed families are hit the hardest.[1]

Recent growth in overdraft fees has been fueled by unfair practices that include (1) posting charges against a checking account quickly while intentionally delaying the posting of deposits, (2) lowering account balances by re-ordering debits to clear higher-dollar items first, and (3) failing to warn a customer during debit card point-of-sale or ATM transactions if they are about to overdraw their account, so that they may cancel the transaction if they choose.

In this report, we update our earlier $10.3 billion estimate of the annual cost of abusive overdraft lending based on our analysis of a large, commercially-available database of personal banking account transactions documenting more than 8,500 overdrafts.[2] We also explore some of the reasons behind the growth in overdraft fees, and show how the fees paid for abusive overdraft loans total more than the funds that banks and credit unions lend under these systems.

Specifically,

- **Banks and credit unions use abusive overdraft loans to generate $17.5 billion in fee income each year.**
- **Abusive overdraft loan fees now make up 69 percent of all fees collected when customers overdraw their accounts, vastly outweighing traditional not-sufficient funds (NSF) fees.**
- **In a system enormously out of balance, consumers pay $17.5 billion in fees for $15.8 billion in abusive overdraft loans.**

If these fees were incidental charges based on the occasional overdraft, our findings would be less disturbing. But the volume of abusive overdraft loans has risen dramatically over the past few years, and the impact on cash-strapped families is profound. Reforms are needed immediately to address these problems.

The Center for Responsible Lending (CRL) recommends that consumers choose a bank or credit union that does not make abusive overdraft loans or will allow their customers to opt out of these systems. Consumers should also consider linking their checking account to a savings account or line of credit to protect themselves from the high fees of abusive overdraft loans.

In addition, CRL makes the following recommendations to policymakers:

- Prohibit banks and credit unions from manipulating the order of check clearing or delaying the posting of deposits if doing so results in overdrafts;
- Require banks and credit unions to obtain written consent from customers in order to enroll them in high-cost overdraft loan programs;
- Require banks and credit unions to comply with the Truth-in-Lending Act for high-cost overdraft loans by disclosing their cost in terms of annual percentage rate;
- Limit the number of high-cost overdraft loans a bank or credit union can make to a customer per year to prevent the customer from falling into a cycle of debt;
- Require banks and credit unions to warn customers whenever an ATM withdrawal or debit card point-of-sale (POS) transaction will overdraw their accounts and give them a choice of whether to proceed or to cancel the transaction; and
- Allow banks and credit unions to cover ATM and debit card POS overdrafts without warning only if the customer has elected, in writing, to participate in a lower-cost protection program that pays overdrafts from a linked savings account or line of credit.

Abusive overdraft loan *n.* A small, high-cost loan made by a bank or credit union to an account holder who is "in the red," often without the account holder's affirmative consent. The bank recoups the loan amount plus a fee averaging $34 from the account holder's next deposit. Often marketed inappropriately as "bounce protection," the abusive fee-based overdraft loan should not be confused with cheaper sources of back-up funds for checking accounts, such as a linked savings account or line of credit. While generating fee income for banks, the abusive overdraft loan can make a small purchase, even a sandwich or doughnut, cost the unsuspecting bank customer over $30.

BANK PRACTICES PROMOTE OVERDRAFTS

From disincentive to fee generator

Not so long ago, banks and credit unions routinely declined to honor checks or electronic payments when a checking account holder did not have the funds in their account to cover those payments. They charged customers a "not-sufficient funds" (NSF) fee, and returned the check or denied payment. The NSF fee was intended to discourage the customer from overdrawing their account.

If customers wanted their overdrafts paid, banks and credit unions offered an alternative to denying a payment. Customers could link their checking account to a source of back-up funds—a savings account or line of credit. Typically an effective money management tool, this saved the customer an NSF charge, and sometimes a bounced check fee from the recipient of the check. A line of credit usually carries an APR of less than 20 percent.[3]

Banks now place a significant number of customers into a high-cost overdraft program that automatically honors overdrafts—encourages them in fact—and generates billions of dollars in fee revenues for the banks in the process.

While many banks and credit unions still offer these less expensive options, they now place a significant number of customers into a high-cost overdraft program that automatically honors overdrafts—encourages them in fact—and generates billions of dollars in fee revenues for the banks in the process.

Today's overdraft systems use the high-cost mechanism of abusive overdraft lending

Under today's dominant system, if the customer overdraws their account, the bank or credit union loans the customer the amount of the shortfall rather than declining the transaction or paying it with the customer's own back-up funds. The bank recoups the loan amount plus a fee from the customer's next deposit, which typically occurs in a matter of days.

These fee-based overdraft loans are small—they average $27—so the fees, which now average $34, are very large in proportion—often larger than the loan itself. And because most are paid back very quickly, when the next deposit is made into the account, annualized interest rates are quite high.[4]

Smokescreen hides terms and costs

At many banks and credit unions, customers are enrolled in abusive overdraft loan systems by default when they open checking accounts, often without their express consent.[5] This means that customers generally do not realize that their first overdraft will be covered automatically by a high-interest loan from their bank or credit union. Because each overdraft carries a fee averaging $34, the first fee can drive the account still deeper into the red, causing subsequent overdrafts. Each additional overdraft is routinely approved, creating a downward spiral into debt.

Even after a customer realizes they have unwittingly been enrolled in an abusive overdraft loan program, they may have difficulty opting out of the system or finding a bank that does not engage in the practice.[6]

Furthermore, the Federal Reserve Board has exempted this type of overdraft loan from the Truth-in-Lending Act (TILA), so banks and credit unions do not have to disclose the astronomical interest rates that apply to the short-term, small-dollar loans.

Unfair practices increase overdraft fee income for banks and credit unions

Companies marketing software for overdraft lending systems promise banks that they will double to quadruple their fee-income by implementing these loan programs.[7] Banks and credit unions now use these systems as a key source of income. Abusive overdraft loan fees accounted for over 40 percent of bank and credit union fee income in 2006, up from 27 percent in 2004.[8]

Banks and credit unions can increase their fee revenue further with practices that are unfair to the customer, such as holding deposits, manipulating the order in which they clear checks and debits, or neglecting to warn account holders before they electronically overdraw their accounts.

A spokesperson for a large national bank told the Atlanta Journal Constitution that the bank holds some deposits for as long as they are allowed unless the account holder calls and asks for a quicker credit.

Delayed deposit crediting

One practice that increases the incidence of overdrafts is the holding of deposits for as many as 11 days, even if the deposit clears in a much shorter time period. Federal regulations that set limits on how long deposits can be held were designed to allow time for transporting documents and verifying the availability of funds. For example, banks have two days to credit cash deposited at their own ATMs and five days to credit cash deposited at other banks' ATMs.[9] But these limits have little relationship to the speed at which funds are transferred today.

Financial institutions can use as much of that time as they choose. A spokesperson for a large national bank told the Atlanta Journal Constitution that the bank holds some deposits for as long as they are allowed unless the account holder calls and asks for a quicker credit.[10]

On the other hand, the Check Clearing for the 21st Century Act (Check 21), implemented in 2004, allows banks and credit unions to clear checks more quickly, further widening the gap in banks' posting of account credits versus debits.

Manipulation of check ordering and debit clearing

Another practice that can increase bank revenue from overdraft fees is that of manipulating the order that checks or debits clear a customer's account so that higher amounts clear before lower amounts. Since abusive overdraft loan fees are assessed as flat fees per incident regardless of the dollar value of the loan, consumers may pay more in fees if their largest transactions go through first.

Financial institutions' clearing practices differ, but their written policies reserve the right to pay in the order they choose, and not necessarily in the order in which payments were made.

For example, US Bank's policy states:

> **Our Options:** When an item of yours overdraws an account, we can either pay or refuse to pay the item.
>
> If we get a **batch** of such items in a day (checks typically come in batches), and if one, some or all of them would overdraw the account if paid, we can pay or refuse to pay them, in any order, or no order. For example, if one large check and six small checks are offered to us for payment, and the one large check would empty the account, we can:
>
> (1) pay the one large check and refuse to pay the six small checks;
> (2) pay the small checks and refuse to pay the large check;
> (3) pay all of them, creating an overdraft; or
> (4) pay some and reject others.
>
> We have all these options each time you might overdraw an account. What we do one time does not make that a rule you can rely on for the future.[11]

For an illustration of how this could play out, assume an account holder has $750 in her checking account. Before she realizes she is not covered, she pays some bills and makes some small dollar purchases, putting her $143 in the negative.

The order in which these payments clear her checking account makes a big difference in the cost of that shortfall. If the payments were presented to the financial institution on the same day, in the order in Scenario A below, and if they were cleared in the order they were presented, she would be charged like this:

Scenario A: Chronological Ordering of Charges

Transaction	Charge	Account Balance	Average Overdraft Fee
		750	
Credit card payment – ACH	90	660	
Water bill – check	30	630	
Groceries purchase – debit card	65	565	
Gas purchase – debit card	25	540	
Lunch purchase – debit card	10	530	
Drugstore purchase – debit card	15	515	
Family gym fees – check	40	475	
Coffee purchase – debit	8	467	
Bookstore purchase – debit card	10	457	
Rent – check	600	(143)	$34
TOTAL OVERDRAFT LOANS		$(143)	
TOTAL OVERDRAFT FEES			$34
Balance with fees deducted		$(177)	

On the other hand, if the payments were cleared from the largest to the smallest, the amount by which her account was overdrawn would remain the same, but the charges would be significantly higher.

Scenario B: High-dollar Ordering of Charges

Transaction	Charge	Account Balance	Average Overdraft Fee
		750	
Rent – check	600	150	
Credit card payment – ACH	90	60	
Groceries purchase – debit card	65	(5)	34
Family gym fees – check	40	(45)	34
Water bill – check	30	(75)	34
Gas purchase – debit card	25	(100)	34
Drugstore purchase – debit card	15	(115)	34
Lunch purchase – debit card	10	(125)	34
Bookstore purchase – debit card	10	(135)	34
Coffee purchase – debit card	8	(143)	34
TOTAL OVERDRAFT LOANS		$(143)	
TOTAL OVERDRAFT FEES			$272
Balance with fees deducted		$(415)	

Banks and credit unions claim that their overdraft programs are providing customers a service—protection from returned check fees. But this argument is disingenuous, because in either scenario above, all the transactions are paid. The only difference is that in Scenario B, the bank or credit union increases their fee income by manipulating the order in which they clear the payments.

Of course, if the bank customer had no overdraft program in place at all, her rent would likely be paid late. But even if her landlord charged her a late fee of $30 (five percent of the rent) and her bank charged an NSF of $20, for a total of $50, she would still come out better than she would under Scenario B, which cost her $272.

Failure to warn debit card customers or decline transactions

A third practice that increases overdrafts is that of authorizing debit card payments and ATM withdrawals without warning the account holder of a negative balance. Banks and credit unions have the technology to warn customers or merchants of insufficient funds at the time of a debit card POS purchase or ATM withdrawal—but most do not. They can also decline the transaction to prevent the overdraft charge—but most do not.[12] In fact, as recently as 2004, 80 percent of banks still declined ATM and debit card transactions without charging a fee when a customer did not have sufficient funds in their account.[13]

In January of 2007, CRL published a report finding that debit card purchases at POS terminals and ATM withdrawals trigger 43 percent of overdrafts, much more than paper checks, which trigger just 27 percent of overdrafts.[14] That is because not only are banks and credit unions now allowing overdrafts and charging fees when previously they declined transactions, but consumers are increasingly using debit cards for small purchases where they previously used cash. Debit card use tripled from 2000 to 2005, while paper check use declined by 10 percent.[15]

Banks and credit unions are exploiting the trend toward plastic payments as a source of fee revenue. And debit card-triggered overdraft loans are especially costly for consumers because they carry the same high flat-rate fee, averaging $34, for what is generally a small value transaction, with an average loan amount of under $17.[16]

In a CRL survey, we found that respondents do want the option of canceling those transactions, and most would prefer that their transaction be declined, even at the checkout counter, rather than that the bank approve it and charge an overdraft fee.[17]

These ATM and debit card POS overdrafts cost consumers $7.8 billion a year in fees for transactions that could easily be prevented with an insufficient funds warning at the checkout or ATM machine. (See appendix for calculation methodology.)

Debit card-triggered overdraft loans are especially costly for consumers because they carry the same high flat-rate fee, averaging $34, for what is generally a small value transaction, with an average loan amount of under $17.

Banks and credit unions collected $17.5 billion in abusive overdraft loan fees in 2006.

A CRL report released in 2005 estimated the cost of overdraft loan fees at $10.3 billion annually, based on a combination of industry-reported figures and estimates from various analysts. Our current analysis updates this figure. We find that banks and credit unions collect $17.5 billion in abusive overdraft loan fees annually.

Our calculations rely on data from a large, commercially-available database of personal banking account transactions documenting more than 8,500 overdrafts (see sidebar) as well as reports on non-interest service charges from financial institutions monitored by the Federal Deposit Insurance Corporation (FDIC) and on non-interest fee income from the National Credit Union Association (NCUA).

Table 1: Estimated Fee-Based Overdraft Loan Fees Paid by Consumers

	2004	2006
Non-interest fee income/service charges[18] (A)	$38.0 billion	$42.2 billion
Estimated percent of non-interest fee income attributable to overdraft loan and NSF fees combined (B)	45%	60%
Overdraft loan and NSF fees combined (C) = (A) * (B)	$17.1 billion	$25.3 billion
Estimated percent of overdraft/NSF fees due only to fee-based overdraft loans (D)	60%	69%
Estimated fee-based overdraft loan fees (C) * (D)	$10.3 billion	$17.5 billion

FDIC and NCUA call reports show financial institutions took in $42.2 billion in service charge revenue in 2006—an 11 percent increase over the $38 billion they made in 2004.[19]

We estimate an increase in the proportion of fee income derived from overdraft-related fees (fees for fee-based overdraft loans and NSFs combined) from 45 percent in 2004 to 60 percent in 2006. This increase is based on our analysis of the Ultimate Consumer Panel database, corroborated by a specific estimate of 60 percent from the investment research firm Sanford Bernstein.[20]

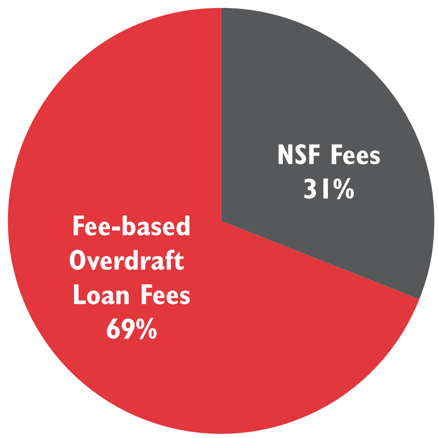
About the Data

For our analysis, CRL used data from a consumer panel tracked by Lightspeed Research Inc. called the Ultimate Consumer Panel. This dataset was originally developed by Forrester Research in 2004 and included information for 5,681 U.S. households whose transaction-level online and offline banking account activity was electronically captured. The dataset contained 18 months of data (from January 2005 to June 2006) on 3,279,522 transactions.

Fee-based overdraft loans account for 69 percent of overdraft and NSF fees combined.

The increase in combined overdraft fees attributable to overdraft loans, from our estimate of 60 percent in 2004 to 69 percent in 2006, is based on data from the Ultimate Consumer Panel, and indicates an important shift in bank policy. While banks and credit unions once covered overdrafts as an occasional "courtesy," they have now moved to a system that routinely approves overdrafts on all types of transactions, generating a fee for each incident. Abusive overdraft loans, once the exception, are now the rule.

Figure 1. Overdraft-Related Fees by Type



Source: CRL Analysis of Ultimate Consumer Panel database

The widening ratio of overdraft fees to NSF fees is the result of two shifts in banking policy discussed earlier.

- One, the widespread adoption of fee-based overdraft loan systems by banks. On transactions where institutions previously declined payment and charged NSF fees, such as checks, they now typically pay the overdraft and charge an overdraft loan fee rather than an NSF fee.

- Two, the expansion of overdraft systems to permit overdrafts on debit card and ATM transactions. Banks and credit unions have reduced the number of NSF fees they charge, but they have vastly increased the number of overdraft fees they charge by allowing overdrafts for transactions that did not trigger NSF fees in the past, because they were declined.

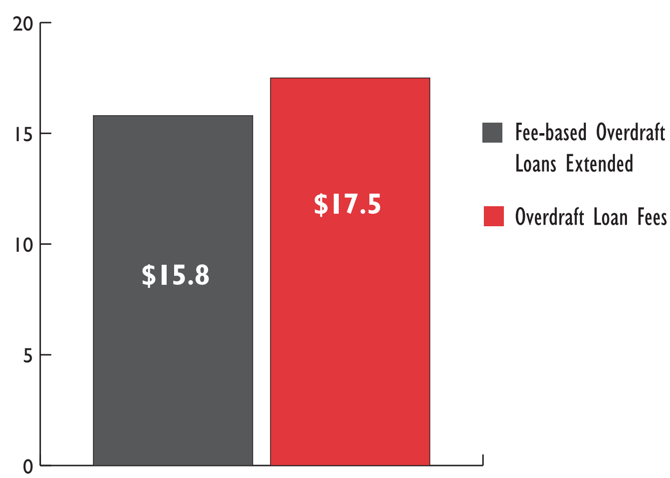
Banks and credit unions have long maintained that the purpose of the NSF fee is to deter customers from attempting to spend money they don't have, and this has also been the justification for the size of the fee. By routinely approving overdrafts, however, banks and credit unions have shifted from charging a fee intended to deter overdrafts to charging the fee as interest on a short-term loan.

The income-generating potential of overdraft loan interest has become a powerful incentive for institutions to promote rather than discourage overdrafts. Banks and credit unions have adopted systems that encourage repeated overdrafts—indeed, even create overdrafts where they would otherwise not occur—and in so doing have reaped billions of dollars in fees from low- and moderate-income consumers.

Consumers pay $17.5 billion in fees for $15.8 billion in abusive overdraft loans.

Our analysis shows that banks and credit unions extend $15.8 billion in high-cost, unsolicited loans to their customers to cover overdrafts each year. Using fee-per-dollar-borrowed figures from *Debit Card Danger*, we find that the total value of overdraft loans is only 90.2 percent of the $17.5 billion in fees that banks and credit unions collect, or $15.8 billion.

Figure 2. Consumers pay back more in overdraft fees than total loans extended



This an extreme imbalance, especially considering that the typical overdraft loan is paid back in fewer than five days. The disparity in fees to loans will likely continue to widen, since debit card use is growing,[21] and because debit card point-of-sale purchases cost more in fees per dollar borrowed than other types of overdraft loans. Consumers pay $1.94 in fees for every dollar borrowed to cover overdrafts made at the checkout counter.[22]

This imbalance makes abusive overdraft lending similar to the predatory practice of payday lending in that payday lending also costs borrowers more in fees than the total amount they borrow. The typical payday borrower pays back $793 for a $325 loan.[23]

RECOMMENDATIONS

In CRL's second report of a series analyzing the practices and costs of overdraft lending, we find a shift from a customer service-oriented overdraft policy to a fee-generating system of unsolicited loans that unfairly creates more overdrafts. This system costs consumers $17.5 billion per year in abusive fees. Consumers are paying more in abusive overdraft loan fees than the amount of the loans themselves.

CRL recommends that consumers choose a bank or credit union that does not make abusive overdraft loans or that will allow their customers to opt out of these systems. Consumers should also consider linking their checking account to a savings account or line of credit to prevent the high charges for abusive overdraft loans.

In addition, CRL makes the following recommendations to policymakers:

- Prohibit banks and credit unions from manipulating the order of check clearing or delaying the posting of deposits if doing so results in overdrafts;

- Require banks and credit unions to obtain written consent from customers in order to enroll them in high-cost overdraft loan programs;

- Require banks and credit unions to comply with the Truth-in-Lending Act for high-cost overdraft loans by disclosing their cost in terms of annual percentage rate;

- Limit the number of high-cost overdraft loans a bank or credit union can make to a customer per year to prevent the customer from falling into a cycle of debt;

- Require banks and credit unions to warn customers whenever an ATM withdrawal or debit card point-of-sale (POS) transaction will overdraw their accounts and give them a choice of whether to proceed or to cancel the transaction; and

- Allow banks and credit unions to cover ATM and debit card POS overdrafts without warning only if the customer has elected, in writing, to participate in a lower-cost protection program that pays overdrafts from a linked savings account or line of credit.

APPENDIX: METHODOLOGY

CRL analyzed 18 months of bank account transactions from participants in Lightspeed Research's Ultimate Consumer Panel, from January 2005 to June 2006. Each month's data contained every transaction for each registered account, date-stamped but not time-stamped. Some panelists registered more than one account; some participated sporadically.

We selected panelists who participated in the panel for at least six consecutive months within the 18-month window, and chose only one checking account from each—the one with the earliest logged transaction. To perform the analyses specific to this report, we selected only panelists who had at least one overdraft incident. Our final panel for these analyses contained 4,036 consumers.

Identifying fee-based overdraft loan and NSF charges

We analyzed accounts from the 15 largest banks in the nation; approximately 66 percent of all transactions in the dataset are associated with an account at one of these banks. Transaction descriptions are captured verbatim and are not consistent from one institution to another, therefore we began the process of identifying overdraft and NSF fees by creating standard filters for transaction and balance information.

To most accurately capture the relevant charges, we searched both electronically and manually for transaction lines containing phrases that identified a given transaction as an overdraft or NSF fee. We removed those fees that indicated an association with linked lines-of-credit, savings or credit cards.

In order to get the most accurate breakdown between fee-based overdraft loan and NSF fees for our new estimate, we hand-coded multiple-fee overdraft and NSF transactions, accounting for multiple same-day fees charged all at once by the banking institutions. We found that 69.1 percent of the captured transactions were overdraft transactions, while 30.9 percent were NSF transactions.

Calculating cost from estimates

We obtained our initial figure for aggregate non-interest fee income of $42.2 billion from FDIC and NCUA 2006 Call Report data.

For our estimate that overdraft and NSF fees make up 60 percent of non-interest fee income, we consulted investment research service Sanford Bernstein Research to update their contribution to our 2005 quantification paper. In our May 2007 interview, a Bernstein researcher estimated that for each checking account, banks make $200 in non-interest fees each year. Aggregating the fee income from overdraft and NSF fees in our sample, we get $499,678. Dividing this amount by the 4,036 checking accounts responsible, we get a figure of $123.80 paid in overdraft and NSF fees per checking account. This represents 61.9 percent of Bernstein's estimated $200. We round down slightly to arrive at the conservative estimate of 60 percent. From this, we calculate that $25.3 billion of bank income is attributable to overdraft/NSF fees.

Separating overdraft fees from NSF fees as above, we estimated the proportion of overdraft/NSF fees solely attributable to overdraft, 69.1 percent, and took that proportion of the $25.3 billion overdraft/NSF figure to get $17.5 billion in overdraft fees alone. Briefly,

$42.2B * (0.60) = $25.3B
$25.3B * (0.691) = $17.5B

To find the percentage of fees attributable to debit card POS and ATM transactions, we use the percentage of POS and ATM transactions, 44.3, in our sample from Debit Card Danger.

$17.5B * (.443) = $7.8B

Calculating credit extended

We divided the $17.5 billion into sections triggered by each of the four major transaction types, according to the proportions from Debit Card Danger, omitting the 0.6 percent of the sample attributed to bank fees, and assuming that the mixed ATM/POS portion of the fee volume is distributed the same way as the individual POS and ATM sections. From Debit Card Danger, we find that POS makes up 42.7 percent of non-bank fee overdraft fee volume, ATM makes up 2.0 percent, electronic transactions make up 27.9 percent, and checks make up 27.1 percent.

Dividing these by the fee-per-dollar-borrowed figures from Debit Card Danger and adding them together, we get the aggregate credit extended expressed as a percentage of the fee volume:

(.427/$1.94) + (.02/$.78) + (.279/$.98) + (.271/$.73) = .902 = 90.2%

Assuming the bank fee-triggered transactions would not appreciably change the fee-to-loan proportion, and taking 90.2 percent of the $17.5 billion in fees, we find that $15.8 billion in credit is extended.

NOTES

1 A survey conducted by CRL in 2006 found that 16 percent of account holders who have triggered their bank's overdraft loan system account for 71 percent of overdraft loan fees. The survey found that repeat users had lower incomes than non-repeat users. *See* Lisa James and Peter Smith, *Overdraft Loans: Survey Finds Growing Problem for Consumers,* April 24, 2006. Available at http://www.responsiblelending.org/pdfs/ip013-Overdraft_Survey-0406.pdf. In fact, some banks charge higher fees for account holders who have repeat overdrafts, making it that much more difficult for them to recover from a financial shortfall. For example, JPMorgan Chase Bank charges $25 for the first occurrence during the current month and preceding 12 months, $32 for the second through fourth occurrence, and $35 for the fifth and subsequent occurrences. The bank counts an occurrence as one day in which the account holder is overdrawn. See *Additional Banking Services and Fees for Personal Accounts,* JPMorgan Chase Bank account information, Sept. 15, 2006, on file with the Center for Responsible Lending.

2 In our first published analysis of this database (January 2007), we found that banks are cashing in on a trend toward less use of paper checks and more use of debit cards, charging high fees for very small loans that cover debit card and ATM overdrafts, and failing to give customers the opportunity to cancel transactions that will cost them overdraft fees. See Eric Halperin, Lisa James & Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts,* January 25, 2007. Available at http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf.

3 Citibank Checking Plus variable line of credit was 19.75% as of January 17, 2007. See https://web.da-us.citibank.com/cgi-bin/citifi/scripts/prod_and_service/prod_serv_detail.jsp?BS_Id=CheckingPlus&BV_UseBVCookie=yes, last viewed January 18, 2007. Citibank's Checking Plus product has a $5 annual fee, no transfer fees. Line of credit accounts ideally have no associated transfer fee, but some do. These fees, usually between $5 and $10, can add significantly to the cost of covering overdrafts through a line of credit, albeit at a much lower cost than an overdraft loan. See e.g., *Bank of America Personal Schedule of Fees* at https://www2.bankofamerica.com/efulfillment/documents/89-11-3000ED.20061201.pdf, last viewed January 18, 2007.

4 Using the average debit card POS transaction as an example, a $17 overdraft loan repaid in 5 days with a fee of $34 would carry an annual interest rate of 14,600 percent.

5 Jean Ann Fox & Patrick Woodall, *Overdrawn: Consumers Face Hidden Overdraft Charges From Nation's Largest Banks,* Consumer Federation of America at p2 (June 9, 2005) at http://www.consumerfed.org/pdfs/CFAOverdraftStudyJune2005.pdf. See also John M. Floyd, *Overdraft Program Well Worth the Effort, If Run Responsibly,* American Banker, February 7, 2003.

6 A columnist for a New Jersey newspaper tested the banking industry's claim that these systems are voluntary by accompanying his daughter when she opened an account at Wachovia. The columnist told the account manager that they wanted any transaction to be declined if his daughter did not have the funds to cover it. But months later, when she did not realize her account was empty and made a debit card purchase of less than $2, the transaction was approved and she was charged a $35 overdraft loan fee. See Paul Mulshine, *'Courteous' bankers in for a rude awakening,* The Newark Star-Ledger, June 7, 2007 at p15. Available at http://www.nj.com/columns/ledger/mulshine/index.ssf?/base/columns-0/1181195362176640.xml&coll=1.

7 "Achieve a fee income increase of up to 400% within four months." *Overdraft Privilege Service: A Win-Win Solution to Generating Revenue While Building Customer Loyalty.* Available at http://www.strunklp.com/linkframe.asp?wt=Strunk+%26+Associates%2C+L%2EP%2E&l=http%3A%2F%2Fwww%2Eglobenetix%2Ecom%2Fimages%2Fcustomers%2F128274%2Fstorage%2FCOCC%2520ARTICLE%2EPDF, last viewed January 10, 2007. See also Moebs $ervices, Inc. website page *No-Bounce™ overdraft service* at http://www.moebs.com/Default.aspx?tabid=102 last viewed January 10, 2007. See also *Comment of the American Bankers Association on Proposed Amendments to Commentary to Reg. Z Truth in Lending Act,* Jan. 27, 2003. Available at http://www.federalreserve.gov/SECRS/2005/March/20050331/R-1217/R-1217_181_1.pdf.

8 Fees that are not based on interest are called "non-interest service charges" in bank reports to the FDIC and are called "fee income" in reports from the National Credit Union Association (NCUA).

9 Board of Governors of the Federal Reserve System, *Report to the Congress on the Check Clearing for the 21st Century Act of 2003,* April 2007, p7. Available at http://www.federalreserve.gov/boarddocs/rptcongress/check21/check21.pdf.

10 Peralte C. Paul, *Whose Money is it? Checks Clear Faster than ever, but deposits tend to creep into accounts slowly. Watchdogs want banks to change.* Atlanta Journal Constitution, May 10, 2007.

11 US Bank, T*erms and Conditions for Deposit Accounts,* effective October 15, 2006. Available at https://fastapp.usbank.com/fastapp/en_us/termsAndConditions/TandC/LinkDepositAgreementCurrent.jsp), last viewed June 20, 2007.

12 For all ATM withdrawals and for the vast majority of debit card POS transactions, a swipe of the card sends a balance inquiry over the network before the transaction is approved. See Ron Borzekowski, Elizabeth Kiser, and Shaista Ahmed, *Consumers' Use of Debit Cards: Patterns, Preferences, and Price Response,* Federal Reserve Board, Washington, D.C., April 2006, endnote 6 at p5. All banks have the ability to deny transactions that would cause an overdraft, and some currently maintain a policy of rejecting ATM or debit card POS transactions that cause overdrafts for some or all customers. Examples include the Overdraft Protection and Salary Advance programs of the North Carolina State Employees' Credit Union, available at http://www.ncsecu.org/Products.aspx, last viewed January 18, 2007, and http://www.ncsecu.org/Services.aspx?page=1&item=4&Name=cntlOverdraft and http://www.ncsecu.org/Resources/Publications/PDF/Brochures/Rules_Reg.pdf and USAA Overdraft Protection program, available at https://www.usaa.com/pdf/DaD0406_BillPay0704_SvcFee0606.pdf?cacheid=57814416. Because these transactions occur electronically, banks can identify a potential overdraft and alert a customer before it's too late. Some banks reportedly have already begun warning their account holders about potential overdrafts at their own ATMs. Banks do, however, have the ability to warn even at ATM machines they do not own.

13 Mark Fusaro, *Are "Bounced Check Loans" Really Loans?,* February 2007, at fn4, p6. Available at http://personal.ecu.edu/fusarom/fusarobpintentional.pdf.

14 See *Halperin et al,* endnote 2.

15 *Consumer Payment Systems,* The Nilson Report Issue 869, December 2006 at p8. The Nilson Report defines Consumer Payment Systems as the Purchases of Goods and Services portion of the Personal Consumption Expenditures (PCE) as calculated by the U.S. Department of Commerce's Bureau of Economic Analysis. Consumer Payment Systems includes cash transactions.

16 In comparison, the median loan amount for an overdraft triggered by a check is $41.38. See *Halperin et al*, endnote 2.

17 In our survey, 75 percent of respondents wanted to be warned if they attempted to withdraw more money at an ATM than they had in their account. Only 2 percent of those surveyed said that, if warned and given the choice of continuing or canceling the withdrawal, they would complete the transaction despite the overdraft fee. If a debit card purchase at a checkout cost more than they had in their account, 61 percent of whose with a preference said they would rather "have the bank automatically decline [their] debit card transaction to avoid the overdraft." See *Halperin et al,* endnote 2 at p9.

18 "Non-interest fee income" includes credit card loan fees, mortgage origination fees, real estate fees, fees for traveler's checks, wire transfers, and money orders, debit card interchange fees, membership fees, loan processing fees, NSF fees, and in cases where an institution has a fee-based overdraft program, overdraft fees.

19 FDIC reported $32.8 billion in service charge income in 2004. See *2004 FDIC Statistics on Depository Institutions,* available at http://www2.fdic.gov/sdi/rpt_financial.asp. NCUA reported that credit unions received $5 billion in fee income. See Consolidated Balance Sheet, at http://www.ncua.gov/foia/foia.htm. For purposes of its estimate, CRL rounded the amount of service charge income to the nearest billion.

20 CRL's estimate of 45 percent for overdraft-related fees in 2004 was based on industry estimates ranging from 38 to 70 percent. These estimates were developed by Bretton Woods, Moebs Services, Sheshunoff Management Services, and Sanford Bernstein Research. The first three are research and consulting firms. Of these, Bretton Woods has a "strategic partnership" with Strunk, a vendor of overdraft loan programs, and Moebs and Sheshunoff offer financial institutions their own overdraft loan programs. Sanford Bernstein is an investment research service.

21 See page 7 of this report and *The Nilson Report,* endnote 15.

22 See *Halperin et al,* endnote 2.

23 Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year,* November 30, 2006 at p7-8.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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