

Debit Card Danger:

Banks offer little warning and few choices as customers pay a high price for debit card overdrafts

EXECUTIVE SUMMARY

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January 25, 2007

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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Today, many banks and credit unions enroll customers by default in overdraft or “bounce protection” programs when they open a checking account. Under these programs, the fee a customer pays when the bank covers a withdrawal that exceeds their account balance is actually a finance charge for a loan. The overdraft loan is very short term—and often very expensive. The bank automatically recoups this loan, plus the fee, from the account holder’s next deposit.

Previous Center for Responsible Lending research has found that banks steer account holders into these programs, often without the customer’s knowledge, because the programs lead to more overdrafts—and fee income for the banks. Customers pay the price, and it is enormous. When overdraft fees are translated into an annual percentage rate (APR), the common measure used to express the cost of credit, the APR can run into quadruple digits and higher.

A 2005 research report published by CRL estimated that checking account holders pay more than \$10.3 billion in overdraft loan fees each year. Subsequent research by CRL in 2006 found that nearly three quarters of that amount—\$7.3 billion—is paid by chronic borrowers living on the margins of solvency. Once these financially-strapped households are knocked down into the red, it takes them longer to climb back up to a positive balance.

Our analysis of a large commercially-available database of personal checking account transactions shows that debit card purchases at point-of-sale (POS) machines are the leading cause of overdrafts, topping paper checks, ATM withdrawals and online bill payments. Furthermore, debit card overdraft loans are proportionally more expensive because they carry the same high flat-rate fee for what is generally a smaller value transaction.

Banks have the technology to warn customers or merchants at the time of a debit card POS purchase or ATM withdrawal that the customer’s account has insufficient funds—but most do not. They can also decline the transaction and save the customer the overdraft fee—but most do not. Yet in a survey of consumers, we found that most people would prefer that the bank deny their withdrawal or purchase when they don’t have the money to pay for it.

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For this report, CRL analyzed an independent database of personal banking account transactions documenting more than 8,500 overdrafts, and surveyed 2,400 checking account holders. We find that account holders have more overdrafts caused by a debit card purchase than by a written check, that debit card overdrafts are more costly, and that survey respondents would avoid the fees if given the choice. Specifically:

- Approximately 46 percent of all overdrafts are triggered by debit card (POS) transactions or ATM withdrawals, while paper checks trigger 27 percent of overdrafts.
- Debit card POS overdraft loans are more expensive than overdraft loans from any other source, including overdrafts by check. Debit card POS overdrafts cost people \$2.17 in fees for every dollar borrowed, compared to check overdrafts, which cost \$.86 per dollar borrowed.
- Most survey respondents—over 60 percent—would prefer that the bank deny a debit card purchase that overdraws their account, and nearly all would cancel their ATM withdrawal if warned they had insufficient funds.

We recommend that policymakers fix the systemic problems specific to debit card overdrafts by enacting the following reforms (a full list of overdraft policy recommendations is in the conclusion of this report):

- **Require banks to warn customers whenever an ATM withdrawal or debit card POS transaction will overdraw their account, tell them what the loan will cost, and give them a choice of whether to proceed or to cancel the transaction.**
- **Allow banks to cover ATM and debit card POS overdrafts without warning only if the customer has consented in writing to participate in a lower-cost protection program that pays overdrafts from a linked bank account, line of credit, or credit card.**

**To see the full report, go to
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