

Out of Balance:

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

EXECUTIVE SUMMARY

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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'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.

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. 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.** 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.
- **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.** The widening ratio of overdraft fees to NSF fees is the result of (1) widespread adoption of fee-based overdraft loan systems by banks, and (2) expansion of overdraft programs to allow overdrafts on debit card and ATM transactions that would previously have been declined.
- **In a system enormously out of balance, consumers pay \$17.5 billion in fees for \$15.8 billion in abusive overdraft loans.** This is an extreme imbalance, 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 point-of-sale purchases cost more in fees per dollar borrowed than other types of overdraft loans, and consumer debit card use is growing.

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.

