Overdraft Loans:
Survey Finds Growing Problem for Consumers

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VULNERABLE CONSUMERS CAUGHT IN OVERDRAFT CYCLE

CRL has conducted a survey of overdraft loan customers. Our findings suggest that:

- **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.**
- **Repeat users are in effect using the overdraft loans as an expensive substitute for a line-of-credit, and are paying fees that can be as costly as payday loans.**

The State of Overdraft Loan Programs

One of the most serious threats to people of color and low-wealth families in America is the prevalence of predatory financial practices, which drain $25 billion of their wealth each year.[1] Though predatory mortgage loans and payday loans receive the lion's share of attention as predatory practices, overdraft loan fees comprise about a third of that $25 billion.

Earlier CRL research estimates that checking account customers pay more than $10.3 billion in overdraft loan fees every year.[2] Approximately, three quarters of that, $7.3 billion, is collected from repeat borrowers, rather than one-time users.[3]

Traditionally, depository institutions have selectively covered checks that exceed account balances as an occasional courtesy to depositors. A customer who wanted and qualified for a formal program to protect against overdrafts was offered transfers from a line-of-credit (LOC), a credit card, or linked savings account.

Customer lost nearly $2000 in fees
Arlington, MA

Between July 2005 and January 2006, "Steven," a young hourly-paid mail courier, made a little over $3600 in income. During that same period he was charged $1980 in overdraft loan fees.

Steven uses his debit card to make most of his purchases. Although his account was over $900 overdrawn, his bank was continuing to clear his checks, debit card purchases and was even allowing him to withdraw cash from an ATM.

Over time more and more of Steven's income went to paying his overdraft fees, leaving him with less money for basic expenses, which led to more overdraft loans. Eventually his entire paycheck was going to pay his debt.

Customers who did not qualify for such contractual programs and who demonstrated a pattern of overdrawing a checking account were typically counseled that future overdrafts would not be honored. Financial institutions returned the check to the presenter, charged a Not Sufficient Funds (NSF) fee, and/or closed the customer's account.

Today's customers are placed in overdraft loan programs, the most expensive credit program that the institution offers, often without their consent.[4] The overdraft loan programs extend credit by paying customer's checks, debit card transactions, and ATM withdrawals when customers have insufficient funds in their accounts to cover the withdrawal(s). The institution pays the transaction and charges the customer a fee for lending the money necessary to cover the transaction.[5]

These fee-based overdraft loan programs have proliferated in the past few years. From 2003 to 2005, the number of financial institutions using a vendor-based overdraft loan program increased almost 80 percent to 3,500 institutions.[6] The amount of overdraft fee income has increased as dramatically as the number of programs. Although automating the programs has lowered the costs of making these loans, the average fee charged for overdrafts increased 24 percent from 1998 to 2006, to $26.90.[7] From 2001 to 2004, total service charges on deposit accounts increased 27 percent from $29.7 billion to $37.8 billion.[8] In comparison, the Consumer Price Index (CPI) grew only 6.7 percent from 2001 to 2004.[9]

Consumer Service or Debt Trap?

Vendors and bankers say their overdraft loan programs appeal to a broad range of bank customers who occasionally use the service to cover a missed deposit or math error. One vendor says, "The primary users of overdraft services are middle-income, employed consumers with $50,000 or more in annual household income who have lived at their current address 4 ½ years. They have an average of four years in their present job and 32% own their homes and our studies show that they not only welcome but are demanding such discreet, value-added programs."[10]

However, consumer advocates have raised concerns that the vast majority of fee income is collected from a small number of vulnerable customers who struggle to make ends meet on a recurring basis. The repeat usage by these families suggests that they have become trapped in a payday loan-like cycle of debt.

This cycle begins when an overdraft is paid and the corresponding fee is deducted from an account balance, which then causes additional items to overdraft and additional fees deducted from the account. Only when a deposit is made to the account does the account become positive again. However, the continual deduction of overdraft fees leaves the consumer without enough money in the account to cover monthly expenses, so the pattern repeats itself.

While the market is growing rapidly, there is a dearth of data to definitively answer the question of whether overdraft loans are a consumer service or a debt trap. Thus, the Center for Responsible Lending (CRL) has explored the issue further through direct conversations with customers.

Consumer Survey Raises Troubling Questions Regarding Overdraft Programs

Through Opinion Research Corporation's CARAVAN® Omnibus Survey, CRL conducted a telephone survey among a national sample of adults in the United States.[11]

Our survey found in the responses of 3,310 checking account holders some intriguing—and troubling—information.

CARAVAN® Omnibus Survey

This survey was conducted from October 2005 through January 2006 by the independent research firm Opinion Research Corporation. Survey results are based on telephone interviews with 3,310 adults 18 years of age or older.

See Appendix for methodology, survey questions and Top Line results.

1. **A small group of consumers is paying the majority of fees.** Sixteen percent of overdraft loan users account for 71 percent of overdraft loan fees. A core group of customers (6%) account for almost half of the fees generated by the overdraft product.

Table 1. Percentage of Overdraft Loan (OD) fees paid by repeat users in the past six months

	Total # Repeat OD Loan Users	% OD Loan Users	Total Repeat OD Fees	% OD Fees Paid
Incurred 2 or more OD fees, occurrences spread out	112	16%	422	71%
Incurred 3 or more OD fees	68	10%	364	61%
Incurred 4 or more OD fees	38	6%	274	46%
Total Overdraft Loan Users	684	100%		
Total Times OD Fees Paid			595	100%

2. **Repeat users are more vulnerable than those who have lines-of-credit, or who use fee-based overdraft loans on an *ad hoc* basis. The repeat users are more often low-income, single, non-white renters.**

The survey suggests that the industry description of users is somewhat accurate – the average non-repeat user is 40 to 44 years old and has a household income of $35,000 to $40,000. The data showed that 71 percent of non-repeat users own their own homes. These users, however, account for a small minority of the overdraft loan fees paid each year.

The demographics of checking account holders who reported that they use overdraft loans repeatedly provide a clear contrast to industry's description of the typical user. The average repeat user is 35-39 years old and has a household income of $30,000 to $35,000, and only 61 percent of repeat users own their own homes. Additionally, repeat overdraft loan users are more likely to be unmarried and to be non-white. See Table 2.

Table 2. Demographics of repeat overdraft borrowers versus occasional users

Demographic feature	Incurred 2 or more overdraft fees in past 6 months			Incurred 3 or more overdraft fees in past 6 months			Incurred 4 or more overdraft fees in past 6 months		
	Repeat users	Non-repeat users	Difference	Repeat users	Non-repeat users	Difference	Repeat users	Non-repeat users	Difference
Married	39%	56%	17%**	49%	54%	5%	47%	54%	7%
Home Owner	61%	72%	11%*	60%	71%	11%	56%	71%	15%*
30 years old +	71%	79%	8%*	68%	79%	11%*	74%	78%	4%
$40K+ Household Income	39%	60%	21%**	41%	58%	17%**	44%	57%	13%
White non-Hispanic	52%	70%	18%**	61%	68%	7%	64%	68%	4%

* Significant at a 95% confidence interval.
** Significant at a 99% confidence interval.

3. **Repeat users of overdraft loans are using the overdraft loans as an expensive substitute for lines-of-credit, and are paying fees more akin to payday lending fees than competitive market interest rates.**

As a result of the high fees and short repayment time, borrowers pay triple- and even quadruple-digit interest rates. For example, a $26.90 fee for an $80 overdraft loan translates into a 1,753 percent APR for a loan repaid in a week, or an 877 percent APR if the loan is repaid in two weeks.

A line-of-credit, on the other hand, would have an annual interest rate of 11 percent to 19 percent. For a one-week, 19 percent APR $80 loan the interest expense would be $0.29, for a two-week, 19 percent APR loan the interest expense would be $0.58.

Comparing the costs

$80 one-week overdraft loan with a $26.90 fee:
1,753% annual interest

$80 one-week line-of-credit extension:
19% annual interest
(29 cents)

Further Research Needed on Repeat Usage

This survey is just the first step in understanding the underlying usage patterns of repeat overdraft loan users, and the long-term ramifications for them. The survey began with a nationally representative sample of 4,000 telephone interviews, however the sample size quickly decreased as we narrowed our focus to repeat overdraft loan users.[12] Regulators should require institutions to publicly report information about their overdraft programs in order to provide policymakers, the finance industry and consumers with more evidence of the impact of these loans, especially their impact on repeat users.

The data suggests that repeat users of overdraft loans are more vulnerable than consumers who do not use overdraft loans repeatedly, or who use lines-of-credit to cover overdrafts. Families who lack sufficient income to cover basic and/or emergency expenses are using high-cost overdraft loans to cover these expenses.

High-cost short-term credit such as overdraft loans may exacerbate the income deficit problem by trapping these families in debt.

Research using three different definitions of repeat users and several comparison groups all suggests the same conclusion: a small group incurs most of the $10.3 billion overdraft loan fees, probably becoming "trapped" in a cycle of overdrafting, paying fees and overdrafting again.

Policy Recommendations

The following steps are essential to protecting all Americans with checking accounts:

- The Federal Reserve Board has acknowledged that overdraft coverage is credit in every sense of the term. It should refuse to exempt such programs from the Truth In Lending Act, which requires institutions to disclose the annual percentage rates for loans.[13]
- As is the case with other loan programs, any overdraft loan program should require that borrowers affirmatively and explicitly consent to participate.
- Customers should be warned that an ATM withdrawal or debit transaction would trigger a fee before any relevant transaction is processed, and should be given an opportunity to cancel the transaction.
- Regulators should also require institutions to report data, such as overdraft fee income and the number of borrowers who are taking out multiple overdraft loans within a quarter, which could enable the regulators and the public to understand more clearly the impact of overdraft loan programs on borrowers.
- Repeated overdraft loans that result from more than one incident per quarter should be prohibited.[14]

About the Center for Responsible Lending

The Center for Responsible Lending (CRL) is a national nonprofit, nonpartisan research and policy organization dedicated to protecting home ownership 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.

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

Appendix

Methodology

Opinion Research Corporation's national probability telephone sample (Caravan) is an efficient form of random-digit-dialing. The survey is designed to be a simple random sample of telephone households. Unlike published directories, Caravan's national probability telephone sample includes both unlisted numbers and numbers issued after publication of the directories. A random selection is made from approximately 40,000 exchanges in two million working banks.

The chances are 95 in 100 that a CARAVAN survey result does not vary, plus or minus, by more than 2 percentage points from the result that would be obtained if interviews had been conducted with all persons in the universe represented by the sample.

Questions and Top Line Responses

The next few questions concern your checking account and how your bank may handle overdraft situations.

1 Have you had a checking account at any time during the past six months? (*Yes:3310, No:565)*

2 If you wrote a check for more money than you had in your checking account, would that bank or credit union cover the check? (*Yes:2107, No:443)*

3 Where would the money come from to cover the check? Would it come from…

- 01 A line of credit with that bank *(497)*
- 02 A savings account with that bank *(632)*
- 03 A credit card (*89)*
- 04 The bank would provide the money and repay itself from your next deposit (*716)*

4 Did you sign up for this overdraft protection feature of your checking account or was it automatically available? *(Signed-up: 711, Automatically available: 1198)*

5 Can you access more money than is in your checking account using either an ATM or a debit card? Would you say...

- 01 Yes, by taking out money at an ATM (*161)*
- 02 Yes, by using a debit card for a purchase (*175)*
- 03 Yes, by using both of these methods (*553)*
- 04 Or, you can't access more money by either of these methods (*847)*

6 Many people occasionally overdraw their checking accounts, often accidentally. During the last six months, have you overdrawn your checking account—either because you did not have enough money in your account OR deposited funds were not yet available? (*Yes: 702, No:2521)*

7 And, did your bank cover any of those overdrafts made in the last 6 months? (*Yes:576, No:120)*

(continued next page)

8 How many overdrafts have been covered in the last six months (*Total = 1,426)*

9 How many times have you paid a fee for an overdraft during that time? (*514)*

10 Did all of these overdrafts occur within one week or were they spread out over a longer period of time?

01 Occurred within one week (*73)*
02 Spread out over a longer period of time (*201)*

11 In the last six months, have you ever intentionally written a check or used your ATM or debit card when you knew you did not have enough money in your checking account to cover it? (*Yes: 138, No: 2447)*

12 Have you done any of the following in the past six months to get through times when cash might have been tight?

01 Taken a cash advance on a credit card *(183)*
02 Used a line of credit *(393)*
03 Dipped into savings (975)
04 Borrowed from friends or family *(346)*
05 Gotten a payday loan or cash advance *(36)*
06 Relied on your bank to cover checks or other withdrawals even if there were insufficient funds in your account *(47)*
195 Other *(6)*
197 None *(1779)*

Demographics of repeat overdraft borrowers versus occasional users

Incurred 2 or more overdraft fees in past 6 months

Repeat users N=112 Total N=684

Demographic feature	Repeat users	Non-repeat users	Difference	Statistical Significance
Married	39%	56%	17%	.002**
Home Owner	61%	72%	11%	.029*
30 years old +	71%	79%	8%	.041*
$40K + Household income	39%	60%	21%	0**
White non Hispanic	52%	70%	18%	0**

Incurred 3 or more overdraft fees in past 6 months

Repeat users N=68 Total N=684

Demographic feature	Repeat users	Non-repeat users	Difference	Statistical Significance
Married	49%	54%	5%	.489
Home Owner	60%	71%	11%	.070
30 years old +	68%	79%	11%	.033*
$40K + Household income	41%	58%	17%	.008**
White non Hispanic	61%	68%	7%	.265

Incurred 4 or more overdraft fees in past 6 months

Repeat users N=38 Total N=684

Demographic feature	Repeat users	Non-repeat users	Difference	Statistical Significance
Married	47%	54%	7%	.450
Home Owner	56%	71%	15%	.048*
30 years old +	74%	78%	4%	.524
$40K + Household income	44%	57%	13%	.140
White non Hispanic	64%	68%	4%	.653

* Significant at a 95% confidence interval.
** Significant at a 99% confidence interval.

Notes

[1] CRL estimated cost of predatory financial practices based on: $9.1 billion mortgage, $5.6 billion payday, $7.4 billion overdraft, $1 billion RAL, and $2 billion from other predatory practices including title loans and credit cards.
[2] Jacqueline Duby, Eric Halperin & Lisa James, *High Cost and Hidden From View: The $10 Billion Overdraft Loan Market*, Center for Responsible Lending (May 26, 2005) at www.responsiblelending.org
[3] The Center for Responsible Lending, 2006 Overdraft Loan Survey. Seventy-one percent of overdraft loan users incurred two or more overdraft fees in the past 6 months, occurrences spread out.
[4] John M. Floyd, *Overdraft Program Well Worth The Effort, If Run Responsibly*, American Banker (7 February 2003).
[5] Libby Wells, *Checking study: Fees for bounced checks rising*, Bankrate.com (October 19, 1999) at Bankrate.com/brm/news/chk/19991019.asp.
[6] Based on CRL's estimate: approximately 1,950 programs in 2003; approximately 3,500 programs in 2005. Devised by compiling overdraft installations reported by major overdraft vendors. These estimates do not include new programs developed in-house by financial institutions. Vendor reports from:
2003 data: See *Leading Vendor Warns Consumers: "Be Selective" on Overdraft Programs; Room for Improvement Exists*, Business Wire (4 Dec. 2003), at http://www.findarticles.com/p/articles/mi_m0EIN/is_2003_Dec_4/ai_110919054;
Laura Thompson, *Bank Overdraft Programs Rankle Consumer Groups*, American Banker, May 20, 2003;
Strunk and Associates, *Services*, at http://www.strunklp.com/services.asp?id=127229&page=4;
Neil Christy, *To Fee or Not to Fee*, Bank Director Magazine, (2nd Quarter 2002);
Pinnacle Financial Strategies, *Overdraft Privilege for Credit Unions* at http://www.pinnaclefinancialstrategies.com/products/overdraft/creditunions/benefits.html.
2005 data: Strunk and Associates, press release, *Massachusetts Bankers Assoc Endorses Strunk* (January 1, 2006) at www.globenetix.com/newsletter.asp?id=1282748&page1;
John M. Floyd & Associates, press release *Financial Trends Challenge Banks, Create Opportunities, JMFA Exec Tell IBAT Attendees* (November 29, 2005) at www.jmfa.com;
Mason Lerner, *Moneymakers/Five Questions with Joe Gillen/Catching Checks Before the Bounce* (May 24, 2005) Houston Chronicle;
BSG Financial *News Update*, 2, BSG Financial Quarterly Newsletter (January 2006) at http://www.bsgfinancial.com/PDF/January_2006_Issue.pdf;
IMPACT Your Bottom Line, 4 Impact Financial Services (Spring 2006) at http://www.kybanks.com/uploads/pdf/gn060314impactspnewltr.pdf
[7] The average fee charged for overdrafts increased 24% to $26.90 from 1998 to 2005. See Wells, footnote 4 for 1998 data. For 2005 data:
Greg McBride, *Checking survey: ATM fees hit a record high*, 1 Bankrate.com (December 1, 2005) at http://www.bankrate.com/brm/news/chk/chkstudy/20051201a1.asp.
[8] FDIC reported $32.8 billion in service charge income in 2004. See *2004 FDIC Statistics on Depository Institutions* 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. Financial institutions do not publicly report overdraft fees separately from other fees. They are required to report overdraft fees as a part of service charge income, which includes ATM fees, NSF (not sufficient funds) fees, and credit card fees.
[9] Consumer Price Index (CPI) – grew 6.7% from 2001 (177.1) to 2004 (188.9) CPI – *All Urban Consumers (CPI-U) for the U.S. City Average for All Items, 1982-84=100 CUUR0000SA0* at http://data.bls.gov/cgi-bin/surveymost?cu.
[10] John M. Floyd & Associates press release, *Net Operating Analysis Critical to Success, Veteran Consultant Tells Community Bankers*, PRNewswire, February 23, 2005.
[11] Opinion Research Corporation's CARAVAN® Survey at http://opinionresearch.com/us/omnibus/default. Specific data is on file with the authors.
[12] Eighty-three percent (3,310) of the 4,000-person sample reported that they had a checking account in the prior six months. To cover potential overdrafts, 15% (497) of checking account holders indicated they had a LOC; 22% (716) indicated they were in an overdraft loan program.
Repeat overdraft loan fee usage: Customers who incurred two or more overdraft fees in last six months, with the occurrences spread out N= approximately 112.

Customers who incurred three or more overdraft fees in last six months N= approximately 68.
Customers who incurred four or more overdraft fees in last six months N= approximately 38.

[13] Institutions that cover overdrafts on a truly occasional, ad hoc basis should not be required to make these disclosures. For an analysis of the Federal Reserve Board's regulations and the alleged loopholes exploited by lenders, see CRL's comment to the Federal Reserve Board at http://www.responsiblelending.org/pdfs/Comment-FedFDIC-OverdraftTILA.pdf.

[14] CRL suggests grouping overdrafts as a result of a single incident, even if a number of overdrafts follow from this incident, because one mistake, such as a missed deposit, can cause multiple overdrafts within a short time frame before the customer realizes the mistake.