CENTER FOR RESPONSIBLE LENDING

Support Opt-In Requirement for Overdraft Fees

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In May 2008, the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration issued a joint proposed rule governing overdrafts. The rule would allow financial institutions to continue giving customers expensive loans even though they never asked for them. Research shows that the vast majority of bank customers are automatically signed up to receive costly overdraft loans, but would rather transactions be declined if they don't have sufficient funds in their bank account. But the regulators' proposed rule puts the burden on consumers to *unsubscribe* if they don't want to participate – when they never *subscribed* in the first place.

This proposed rule falls far short of what is needed to protect the savings of American families. Banks should be required to obtain a customer's affirmative, expressed consent —or "opt-in"— before covering an overdraft for a costly fee.

Unauthorized overdraft loans cost consumers billions of dollars each year.

Most major financial institutions automatically enroll customers in a fee-based overdraft loan program without their expressed consent shortly after they open a checking account. Under these systems, the bank or credit union generally pays the customer's checks, debit card transactions, electronic transfers, and ATM withdrawals when the customer's account lacks sufficient funds, in effect lending the consumer the money to cover the transaction. When the customer's next deposit is made, the financial institution charges the amount of the overdrafts, plus a fee averaging $34 for each incident.

These unauthorized overdrafts are unsolicited, high-cost loans that frequently drive customers deeper into debt. Their quadruple-digit interest rates are not required to be disclosed. Here are some of the most egregious problems with the current system:

- Americans pay $17.5 billion per year in fees for unauthorized overdraft loans, which is more than the $15.8 billion paid out in the overdraft loans themselves.
- Debit card overdrafts are now the single largest cause of overdraft fees. Most debit point-of-sale overdrafts are small, averaging less than half of the average $34 overdraft fee.
- Most debit card overdrafts could be easily prevented with a warning or denial. In fact, as recently as 2004, 80 percent of banks still declined debit card transactions without charging a fee. Today, debit card swipes cost Americans billions of dollars each year.
- Research shows that low-income families pay a disproportionate share of overdraft loan fees, meaning these fees have the greatest impact on those who can least afford them.

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Requiring them to unsubscribe from overdraft programs unfairly burdens consumers.

The proposed rule places the burden of having to unsubscribe from an abusive, expensive overdraft system entirely on the consumer. In other business contexts, this arrangement would be considered preposterous. In retail, for example, buyers are not asked to request *not* to be charged for products or services *they never ordered in the first place*; rather, the consumer must take some affirmative step before being expected to pay for something. In lending, requiring borrowers to ask *not* to be given a loan is unheard of outside of unauthorized overdraft systems.

Consumers overwhelmingly prefer choice regarding overdraft.

- An overwhelming percentage of consumers (88%) want the option to choose whether an overdraft loan program is included with their account.
- An argument for *affirmative*, *explicit*, *opt-in* choice is strengthened by the overwhelming percentage of consumers (80%) who would rather have their transaction denied at the counter than be charged an overdraft fee for a debit card transaction.
- Consumers should be given the chance to make an affirmative choice among reasonably priced lower-cost alternatives, such as a linked savings account arrangement or an overdraft line of credit.

Individuals are unlikely to opt out of programs in which they are automatically enrolled.

A number of studies in a wide range of contexts have shown that people do not tend to opt out of programs in large numbers. Many common marketing techniques exploit this tendency:

- Television offers promising 30-day money-back guarantees assume that many customers just won't get around to returning the item even if they don't like it.
- CD-of-the-month clubs assume that many customers, even those who would not actively choose to purchase that month's CD, will not mail back the monthly card to refuse the CD and will end up paying for it anyway.

Marketers design these techniques to "get people in," because it's unlikely they will later get out. The techniques would not be so common if they didn't, to a large extent, work. And with fee-based overdraft programs, customers often have no idea when they open a *checking account* that they are also being automatically enrolled in an expensive *loan program*.

The default arrangement should provide consumers with the greatest benefit.

Given the low likelihood that people will unsubscribe, the default policy should place consumers in the arrangement that provides them with the greatest benefit, which is clearly not one that costs Americans more in fees than the amount of the loans themselves. In fact, with debit overdrafts, the cost averages twice the amount of the transaction, while the cost of being denied is zero. If consumers were warned they would be charged a $34 fee for buying a $2 donut, they might instead choose to hand the clerk a $5 bill – or skip the donut. The proposed rule would only be justified if consumers preferred to be enrolled in these overdraft programs and received real benefits from them. But evidence overwhelmingly shows that consumers don't want overdraft loans and don't benefit from them; thus, they should not be strapped with the burden of escaping this expensive trap.

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