Billion Dollar Deal

Banks swipe fees as young adults swipe debit cards, colleges play along

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EXECUTIVE SUMMARY

As two trends collide—increasing use of debit cards among young adults and increasing use of abusive overdraft practices among major banks—college students and young workers just starting their adult lives are paying a high price.

At least one hundred universities are contributing to this problem by selecting a single bank and granting them exclusive marketing privileges on campus. Such an arrangement might, for example, involve providing students with an official identification card that doubles as a debit card backed by the university's partner bank. When the partner bank uses abusive overdraft practices, these deals come at the expense of the students' financial well-being.

For reports released earlier this year, the Center for Responsible Lending analyzed a large, commercially-available database of personal bank account transactions.[1] We found that abusive overdraft lending practices are costing consumers $17.5 billion per year in fees for only $15.8 billion in loans, and that banks are routinely authorizing small overdrafts and charging $34 fees without warning.

In this report, we focus on the youngest account holders in the same database, those 18 to 24 years old, and find that:

- Banks use abusive overdraft loans to collect nearly $1 billion per year in fees from young adults who earn relatively little as students or new members of the workforce;

- Debit card point-of-sale (POS) transactions are the leading cause of overdraft loans for young adults;

- Young adults pay more than $3 for every $1 borrowed for debit card overdrafts.

<u>Recommendations</u>

Abusive overdraft practices by banks are stripping funds from the checking accounts of young adults. Many students and young workers find themselves owing hundreds of dollars in fees before they even realize they have overdrawn their accounts.

- To avoid putting their students' financial welfare at risk, universities should not partner with banks that make abusive overdraft loans.

- Young adults should choose a bank that does not make abusive overdraft loans and that will link their checking account to their savings account or a less expensive line of credit for back-up funds.

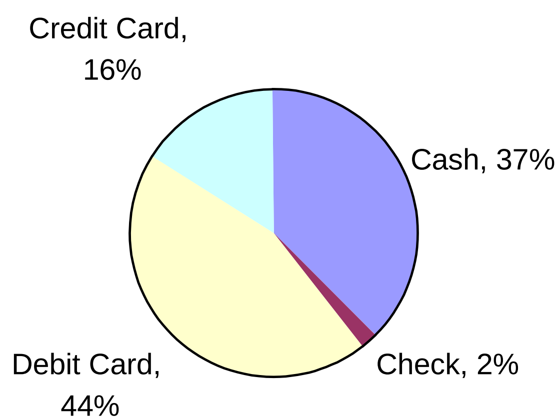
- Policymakers should take the following steps to protect all consumers from abusive overdraft lending practices, which have been outlined in more detail in previous CRL papers:
    - Prohibit banks and credit unions from manipulating the order of check clearing or delaying the posting of deposits if 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 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.

GENERATION PLASTIC AND OVERDRAFT LENDING: TWO TRENDS COLLIDE

Young adults with checking accounts are more likely than most other age groups to use a debit card, and they use them routinely for small purchases like books, meals and snacks. A study commissioned by Visa USA found that debit cards are the primary method of payment for young adults making a purchase for under $25.[2] (See Figure 1.)

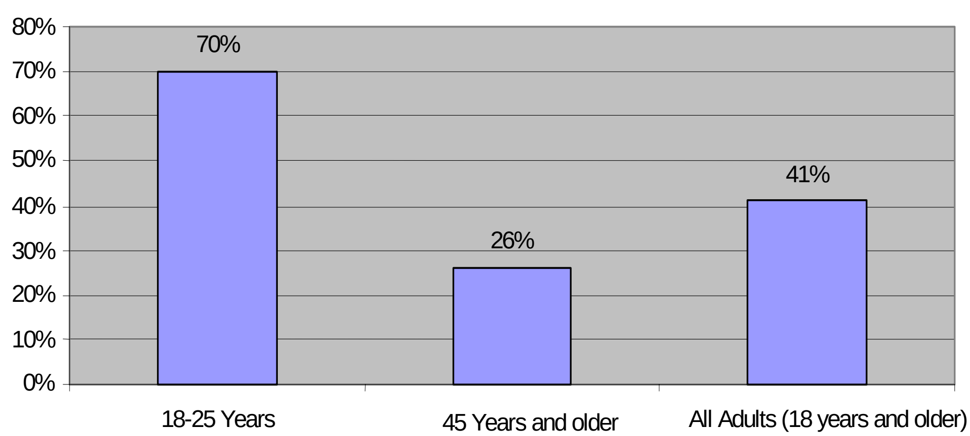
Figure 1. Primary payment method for young adults for purchases less than $25



Source: Visa USA Generation P Survey, 2006

For very small purchases, young adults are far more likely to use a debit card than older adults. Seven out of ten young adults would use a debit card for purchases costing less than $2.[3] (See Figure 2.)

Figure 2. Percent willing to use a debit card for purchases under $2



Source: Visa USA Generation P Survey, 2006

Young adults pay a high cost for their frequent debit card use, as banks and credit unions increasingly approve debit card overdrafts and charge hefty fees for each incident.

Banks and credit unions once discouraged customers from overdrawing their accounts by routinely denying transactions when the account holder did not have enough money, and charging not-sufficient funds (NSF) fees. Debit card and ATM transactions that would result in an overdraft were denied at no cost to the consumer. Customers seeking a source of back-up funds to accommodate the occasional overdraft could link their checking account to a low-cost line of credit (with an annual percentage rate of under 20 percent) or a savings account.

Young adults pay a high cost for their frequent debit card use, as banks and credit unions increasingly approve debit card overdrafts and charge hefty fees for each incident.

Now banks implicitly encourage their customers to spend more than their account balance. Customers are typically placed in an abusive overdraft loan program automatically when they open a checking account.[4] Under this system, banks make high-cost, unsolicited loans to cover a check, debit card purchase, ATM withdrawal, or other electronic transaction when there is not enough money in the customer's bank account. The bank charges the customer a fee averaging $34 for each overdraft transaction it covers and is repaid with the next deposit into the account. Some banks levy additional fees for each day the account balance remains negative.

Banks increase the incidence of overdrafts with unfair practices that include delaying deposits, clearing debits from the highest dollar amount to the lowest, regardless of the order in which they were received, and failing to warn debit card users before they overdraw at an ATM or checkout counter.[5] These practices are described in detail in CRL's previous reports, such as *Debit Card Danger* and *Out of Balance*.

The bulk of overdraft loans are caused by debit card point-of-sale transactions for small, everyday purchases.

Industry representatives assert that overdraft loans are provided as a service to customers who might otherwise bounce their mortgage or car payment, resulting in costly late fees and impaired credit. They say their banks clear debits in order of largest to smallest to ensure that their account holders' largest expenditures are paid. But this argument is disingenuous, as banks typically pay *all* overdrafts—if they paid the smallest first those mortgage and rent payments would still be paid, but the bank would be able to charge fewer overdraft fees.

The bulk of overdraft loans are caused by debit card POS transactions for small, everyday purchases. Because these debit card overdraft loans are very small, the fees are often larger than the loans themselves. And because customers often pay back these loans quickly from their next deposit, annualized interest rates are extremely high.

In a recent survey conducted for CRL by Lightspeed Research, respondents overwhelmingly stated that they wanted to be warned—or have the transaction denied by the bank—if they were in danger of incurring a costly overdraft fee through a debit card transaction or ATM withdrawal.[6]

About the Data

For our analysis, CRL used data from a consumer panel tracked by Lightspeed Research Inc. Our analysis included data for 5,681 households whose transaction-level online and offline banking account activity was electronically captured. The dataset contained 18 months of data on 3,279,522 transactions.

FINDINGS

To determine the impact of abusive overdraft loan programs on young adults, we analyzed the checking account transactions of 18- to 24-year-old account holders spanning an 18-month period, using data from a consumer tracking panel managed by Lightspeed Research. (See Appendix for an explanation of our methodology.)

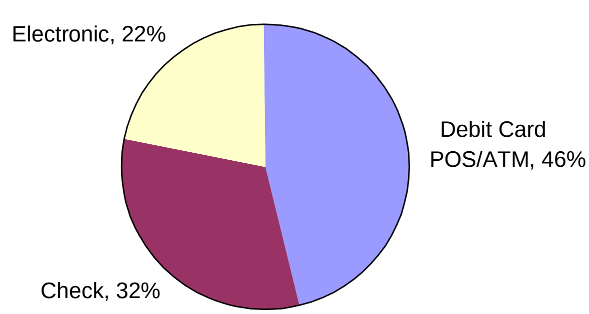
Finding 1: Banks use abusive overdraft loans to collect nearly $1 billion per year in fees from young adults.

Previous CRL research found that banks and credit unions collect $17.5 billion in abusive overdraft fees each year. Young adults, who on average earn less and have far fewer financial resources at their disposal than other account holders, pay $963 million of those fees.[7]

Finding 2: Debit card point-of-sale transactions are the leading cause of overdraft loans for young adults.

Young adults tend to use debit cards more frequently than other payment options. These transactions—coupled with ATM withdrawals—are the cause of nearly half (46%) of all overdraft loans associated with this age group. (See Figure 3.)

Figure 3. Overdraft fee triggers



Finding 3: Young adults pay more than $3 for every $1 borrowed for debit card overdrafts.

While overdraft loans resulting from debit card transactions tend to be a very costly form of credit for all account holders no matter their age, they are even more expensive for young adults, who tend to use their debit cards for smaller value purchases than do adults overall.

As shown in the table below (see Table 1), the average debit transaction amount that causes an overdraft for young adults is $12. For these transactions, the bank lends an average of $10 to cover the overdraft and charges a $33 overdraft fee.

Table 1. Median fee for debit-triggered overdraft loans

	Median Fee	Median Transaction	Median Overdraft Loan	Median Fee per $1 Borrowed
Young Adults (Age 18-24)	$33	$12.00	$10.00	$3.25
All Adults	$34	$20.00	$16.46	$1.94

UNIVERSITY POLICIES PUT STUDENTS AT RISK

When their bank engages in abusive overdraft practices, young adults can potentially lose hundreds of dollars in just one day because of the domino effect of overdrafts that are promoted rather than prevented by the bank.

One college student, G.C., had just this experience when he used his debit card over the course of four days, spending less than $17 for coffee, supplies, and other small purchases while studying for exams. As shown in the table below, G.C. was charged $245 (his bank charged $35 for each incident) for overdrawing his account by about $13.[8] (See Table 2.)

Table 2. Student's transaction history showing overdraft domino effect

Transaction #	Date	Transaction	Overdraft Loan	Overdraft Fee
1	3/30/2007	$4.58	$1.09	$35
2	3/30/2007	$1.94	$1.94	$35
3	4/02/2007	$3.01	$3.01	$35
4	4/02/2007	$1.79	$1.79	$35
5	4/02/2007	$1.79	$1.79	$35
6	4/02/2007	$1.74	$1.74	$35
7	4/02/2007	$1.70	$1.70	$35
Total		**$16.55**	**$13.06**	**$245**

If G.C. had been warned or had his transactions denied, he would have stopped at the first $5 transaction, saving over $200 in fees.

Like credit cards and other financial products, checking accounts are heavily marketed to students as they begin their college careers. These checking accounts commonly feature abusive overdraft loan terms.

Recently, relationships between universities and financial institutions have come under fire from policymakers seeking to lower the cost of student loans. Observers have warned that university/bank partnerships may not be in the best interest of students. Such collaborations have helped financial institutions gain access to college students who are considering opening their first checking accounts.

When their bank engages in abusive overdraft practices, young adults can potentially lose hundreds of dollars in just one day because of the domino-effect of overdrafts that are promoted rather than prevented by the bank.

Since the early 1990s, more than 100 universities have formed partnerships with banks to offer co-branded university ID cards that double as debit cards tied to a checking account with the partnering bank.[9] Through these arrangements, banks gain exclusive access to a large student population they hope to turn into lifelong customers; at the same time they offer universities the potential of significant revenue.

For example, US Bank has described its partnership with the University of Wisconsin-Oshkosh as "a pure revenue opportunity" for the school.[10] In return for allowing only US Bank ATMs on campus and issuing a co-branded university ID card, the university received a signing bonus plus fees based on the number of accounts opened.[11] A debit card issuer that partners with universities—Higher One—splits the fees it collects on debit card transactions with its partner schools.[12]

The dual purpose cards have proven to be popular with students; at least half of those eligible to open accounts with the partnering bank do so.

<u>Take-up rates for some co-branded university ID cards</u>

- Pace University: 11,000 out of 13,000 students[13]
- University of Wisconsin-Stevens Point: 5,712 out of 7,788 students and staff[14]
- 50% of students at schools partnering with Wachovia, including the University of North Carolina[15]

Unfortunately, universities entering these partnerships have failed to recognize and protect their students from abusive overdraft lending practices. While Higher One states that it will prevent overdrafts when possible,[16] many banks engaged in these partnerships use the abusive overdraft loan program as the default for student checking accounts. An investigation by the Milwaukee Journal Sentinel found that the bank partnering with a nearby university charged higher overdraft fees than other area banks.[17] For example, a smaller, local bank charges its customers $15 per overdraft, less than half the fee charged by the university's partnering financial institution.[18]

"These cards are financial training wheels... from our perspective it wasn't a good fit to have them hit with overdraft fees."

- Ohio State University administrator

The prospect of college students falling prey to high overdraft fees has led some school administrators to be wary of partnering with banks. As the director of the student ID office at Ohio State University notes, "these cards are financial training wheels, since a lot of kids have not previously had checking accounts and debit or credit cards…from our perspective it wasn't a good fit to have them hit with overdraft fees."[19]

RECOMMENDATIONS

Many consumers are unwittingly put into abusive overdraft loan systems by their bank or credit union when they open a checking account. These systems encourage overdrafts, especially through debit card POS transactions and ATM withdrawals, and the fee is typically more than $30 for each overdraft. Young adults are especially vulnerable to the risk of high overdraft charges since they use debit cards frequently, even for very small transactions.

- To avoid jeopardizing their students' financial welfare, universities should not partner with banks that make abusive overdraft loans.

- Young adults should choose a bank that does not make abusive overdraft loans, and that will link their checking account to their savings account or a less expensive line of credit for back-up funds

- Policymakers should take the following steps to protect all consumers from abusive overdraft lending practices:

    - 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 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

Many of the results and methods in this report rely on the results and methods of CRL's two previous 2007 overdraft reports, *Debit Card Danger* and *Out of Balance*. Those reports are available online at http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf and http://www.responsiblelending.org/pdfs/out-of-balance-report-7-10-final.pdf.

Identifying overdrafts from panelists age 18 to 24

For our previous 2007 reports, CRL analyzed 18 months of bank account transactions from participants in a consumer tracking panel managed by Lightspeed Research. We selected panelists who participated in the panel for at least six consecutive months within the 18-month window, which was from January 2005 though June 2006, and had at least one overdraft incident.

For this report, we used the same weighted subset of account holders and abusive overdrafts. From this base of 4,036 consumers, we identified 775 abusive overdraft transactions made by 100 panelists between the ages of 18 and 24. In all, 18- to 24-year-olds make up 10.68% of total panelists and accounted for 5.67% of abusive overdraft transactions.

Debit card POS transactions are the leading cause of overdraft loans for young adults

As in our previous research, we identified fee-based overdraft loans and the transactions that triggered them for this report. We analyzed the accounts of panelists age 18 to 24 to determine which type of transaction caused an overdraft: a debit card POS, ATM, other electronic transaction, or check. In some cases, more than one transaction type could have triggered an overdraft. For example, if a debit card POS transaction and an ATM withdrawal occurred on the same day and we did not have enough information to identify the exact trigger, it would be coded as a "mixed trigger" (in this case ATM/POS).

We broke down the 775 abusive overdrafts in our sample by triggering transaction type, and found that 41 percent are caused by debit card POS transactions, and that 46 percent are caused by either debit card POS or ATM transactions.

Table A1: Type of transaction triggering overdraft loans by percentage

Transaction Type Triggering Abusive Overdraft Loan	Percent
Total Debit Card POS or ATM	46%
Debit Card POS: 41%	
ATM/POS (mixed): 4%	
ATM: 1%	
Check	32%
Electronic Transaction	22%

Young adults pay more than $3 for every $1 borrowed for debit card overdrafts.

We randomly sampled 60 abusive overdraft incidents and calculated several relevant statistics, using the account history surrounding each incident. We looked at fee amount, triggering transaction amount, days required to repay the loan and fee, fees assessed per dollar borrowed, and overdraft loan amount (usually only a portion of the triggering transaction amount, as in the case of a $10 purchase causing an overdraft of $5). In selected cases where these values couldn't be calculated because of ambiguities in the account data, new cases were randomly selected.

Table A2: Median fee for debit-triggered overdraft loans

	Median Fee	Median Transaction	Median Overdraft Loan	Median Fee per $1 Borrowed
Young Adults (Age 18-24)	$33	$12.00	$10.00	$3.25
All Adults	$34	$20.00	$16.46	$1.94

Young adults pay nearly $1 billion in overdraft fees each year

Using the full original panel, we calculated that 18- to 24-year-olds were responsible for nearly 6 percent of all abusive overdraft fees. We took that percentage of the aggregate cost of abusive overdraft loan fees ($17.5 billion, calculated in *Out of Balance*), adjusted to account for the difference in median fee amount ($34 for full panel, $33 for 18- to 24-year-olds), and arrived at our total: consumers between the ages of 18 and 24 pay $963 million in abusive overdraft loan fees each year.

$17.5 B * (.0567) * ($33/$34) = $963 M

ACKNOWLEDGMENTS

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NOTES

[1] 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,* Center for Responsible Lending, January 25, 2006. *See also,* Eric Halperin & Peter Smith, *Out of Balance: Consumers pay $17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending, July 11, 2007. Both available at www.responsiblelending.org/issues/overdraft.
[2] Visa USA Generation P Survey, conducted July 24-27, 2006. Findings and discussion at http://usa.visa.com/about_visa/press_resources/news/top_story_generation_plastic.html.
[3] See endnote 2.
[4] Jean Ann Fox & Patrick Woodall, *Overdrawn: Consumers Face Hidden Overdraft Charges From Nation's Largest Banks*, Consumer Federation of America, June 9, 2005 at p2. Available at 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 at p7.
[5] For more details on how unfair bank practices result in more overdraft fees, see Halperin et al, *Out of Balance*, endnote 1 at pp5-8. Available at www.responsiblelending.org/pdfs/out-of-balance-report-7-10-final.pdf.
[6] A 2006 CRL survey found that 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 two 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 those with a preference said they would rather "have the bank automatically decline [their] debit card transaction to avoid the overdraft." For complete survey results, see Halperin et al, *Debit Card Danger*, at Appendix 2. Available at www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf.
[7] The Federal Reserve's 2004 Survey of Consumer Finances found that adults under age 35 have a median annual income of $32,900, compared to $43,200 for all adults. In addition, these younger adults have a median net worth of $14,200, compared to $93,100 for all adults. Young adults age 18-24, which make up the youngest portion of this "under 35" subset, likely have even lower income and asset levels. For more information see pages 5 and 8 of Brian Bucks, Arthur Kennickell & Kevin B. Moore, *Recent Changes in Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*, Federal Reserve Bulletin, February 2006.
[8] This victim's story is described in more detail in: Chi Chi Wu, *Testimony before the U.S. House Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit*, July 11, 2007. Available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htwu071107.pdf. Checking account statement on file with authors. After G.C. and his mother made multiple complaints to the bank about the fees, the bank waived all but $70. Even then, G.C. paid $70 to borrow less than $15.
[9] Industry estimates 100 to 125 campus card partnerships. See Nadia Oehlsen, *Banks Go Back to School with Campus Card Partners*, Cards & Payments, October 1, 2006. In addition, CR80News, which tracks university identification technology, estimates 115 partnerships between schools and banks. See *Banks Give College Try With Branded Cards*, ATM & Debit News, August 31, 2006.
[10] Megan Twohey and Paul Gores, *The Price of Convenience*, Milwaukee Journal Sentinel, June 17, 2007.
[11] *U.S. Bank Pays Campus for Access to Students*, Milwaukee Journal Sentinel, June 18, 2007. The agreement between US Bank and the University of Wisconsin at Oshkosh prohibits all financial institutions other than US Bank and the college's own UW-Oshkosh Credit Union from locating ATMs on campus.
[12] Amy Milshtein, *In the Cards*, College Planning & Management, December 2005.
[13] Debra E. Blum, *Do-it-all Campus ID Cards: Too Corporate?* The Chronicle of Higher Education, January 28, 2005.
[14] See *Oehlsen*, endnote 9.

[15] See *Oehlsen*, previous endnote.
[16] An official at Higher One, a co-branded debit card issuer, has stated that they will deny debit card transactions when there are insufficient funds in the student's account whenever possible. Email correspondence with Higher One on file with authors.
[17] See *Twohey & Gores*, endnote 10.
[18] See *Twohey & Gores*, previous endnote.
[19] David Anthony, Director of the Student ID Office at Ohio State University, as quoted in *Twohey & Gores*, see endnote 10.