

THE SECRETS OF OVERDRAFT

How Banks are Making Billions on our Small-Dollar Mistakes

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EXECUTIVE SUMMARY

Most Americans understand that the price of an overdraft is high. Currently, fees are well over thirty dollars in most cases. But fewer are likely to understand how bank policies can catalyze even more fees from overdrafts.

This analysis concludes that bank profitability from overdraft is not driven by consumer choice, but by the manipulation of policies.

After controlling for differences in the amount of consumer deposits held by institutions, fees charged by banks vary greatly. While the largest banks had the most overdraft fee revenue, consumers at many smaller institutions have been paying more on a per-dollar-of-deposits basis.

One misconception is to assume that overdraft is a homogenous product. In fact, the opposite is true.

This is very significant, as the terms of overdraft products have a significant impact in the level of fees paid by consumers. This paper contends that the policies and terms buried in the disclosures manipulate how frequently those fees are charged. Overall, those details can have a greater impact than just the price in explaining why consumers end up paying so much for overdraft.

The solution is not better disclosures. The solution is a product with a simpler structure that ultimately

costs less to use and which comes with better consumer protections.

Variable policies and practices that are disadvantageous to consumers include:

- Differences in the maximum number of overdraft fees charged per day: Among banks surveyed here, the ceiling varied from as few as one to as many as ten.
- Charging per transaction versus “end of day accounting”: Some banks charge a single fee when an account is overdrawn at the end of the day, but others record fees on a per-transaction basis.
- Differences in courtesy cushions: While some banks will not charge for an overage of as much as \$15, others provide no cushion at all.
- High-to-low check sequencing: Banks can choose the order in which they process non-time-stamped transactions (including recurring billpay, checks). By debiting the highest amounts first, bank terms trigger more overdrafts.
- Insufficient funds fees: Some institutions vary in the maximum number of NSF fees they will charge per day. Some will charge NSF fees and overdraft fees during the same overage episode.
- Differing extended overdraft conditions: Some charge extended overdraft fees when accounts

remain overdrawn for more than a few days. Fees can be as little as a few dollars or as much as another overdraft. Some can be levied during the next business day, whereas others only occur after seven to ten days. Some repeat daily, but others are sequenced over longer intervals.

- Differences in when an overdraft can occur: Some banks will not cover non-recurring debit purchases that cause a balance to become negative. Some will not cover an ATM withdrawal that goes over the available funds. However, in order to generate additional fees, most banks will do both with the consent of the consumer.

Consumers are rightfully confused. Our review of comments submitted to the Consumer Financial Protection Bureau (“CFPB”) show that many have signed up for overdraft but fail to understand the mechanics of the service. Many are not aware that they can overdraft even if they have not opted-in for the program. These are policies that are currently allowed but are unfair, creating an un-level playing field that generate billions of dollars in overdraft fees, primarily from low-to-middle income consumers.

This is a big business built upon many small mistakes. The average size of transactions that result in overdrafts is only slightly more than \$20 (CFPB), but the average fee is \$35 and the average episodic cost is \$69. Together, the sum of the costs to consumers

is very high. Overdraft fees generated \$5 billion in revenues for banks in the first six months of 2015.

Regulatory changes that are needed include:

- Prohibit overdraft on non-recurring debit card purchases and ATM withdrawals.
- Require banks to impose a single fee per episode, and only at the close of the business day.
- Prohibit extended overdraft fees and other types of cascading charges.
- Repeat overdraft should trigger underwriting under the Truth-in-Lending Act. When a consumer has recorded more than six overdraft fees in any twelve-month period, the bank should temporarily suspend the account’s overdraft privilege. As a condition of restoring overdraft to the consumer’s account, the institution should underwrite for ability-to-repay. In these cases, the product should be treated as credit and regulated accordingly.
- Simplify posting order; prohibit the use of high-to-low check debit sequencing.

These changes should reduce consumer costs while also creating more clarity. Small budgeting mistakes are often driven by misunderstandings of the terms of overdraft. The consequences of those small mistakes add up to billions of dollars in overdraft charges every year.

REINVESTMENT PARTNERS ADVOCATES FOR ECONOMIC JUSTICE AND OPPORTUNITY. WE PURSUE CHANGE IN THE LENDING PRACTICES OF FINANCIAL INSTITUTIONS IN ORDER TO PROMOTE WEALTH BUILDING AMONG UNDERSERVED COMMUNITIES.

Most Americans understand that the price of an overdraft is high. But fewer are likely to understand that the manner by which banks construct the terms of the overdraft service contribute greatly to the amount that an account holder ultimately spends to utilize the service.

Collectively, the costs paid by consumers are staggering. During the first six months of this year, American households paid an average of more than one million dollars in overdraft fees every hour.

Banks generate billions of dollars from this product every year. Overdraft revenues can be very significant to the overall profitability of a financial institution. Currently, overdraft products cannot reflect consumer choice because they are the result of opaque terms and conditions.

While some overdraft designs are perfectly legal, they are often not fair. A new regulatory framework should address these important questions: First, does this service provide a reasonable benefit relative to its cost? Second, would consumer uptake be as great if product design was simpler and more consistent?

DATA AND METHODS

To underscore the scope of these costs, we cite new data from the Federal Financial Institutional

Examinations Council (“FFIEC”). Their reports for quarter 1 and quarter 2 of 2015 detail exact revenues from overdraft programs at each regulated bank.

The FFIEC data shows that there are great variations in the amount of overdraft fees charged on a dollar-per-dollar deposit basis and that banks differ in the degree to which overdraft revenues support the cost of checking account services.

When these results are combined with commentary supplied by the CFPB’s Consumer Complaint Database, a broader picture emerges that reveals how Americans are often confused by this product and ultimately harmed by its costs.

These variations cannot be discounted as merely the product of variations in consumer preferences. With population groups as large as those served by a multi-billion asset bank, it is unlikely that there are significant differences in payment preferences among consumers served by different banks. In our opinion, the difference in usage rates reflects variations in internal bank policies.

To supplement the opportunities created by this new data, Reinvestment Partners examined fee schedules for overdraft programs at over fifty financial institutions. This review found connections between the fee structure and consumer costs. While most discussion

of overdraft emphasizes the cost of covering a payment, other terms can often be more impactful. Those terms include extended overdraft fees, daily fee limits, overage cushions, posting order, payment of non-recurring debits and payment of overages at ATMs.

THE REGULATORY CONTEXT

Effective from January 2010, amendments to Regulation E make it incumbent upon banks to get consent from consumers before providing some overdraft services. Under the new rules, consumers have to “opt-in” to have their one-time debit card transactions or ATM withdrawals covered by an overdraft.

A CONSUMER MIGHT NEVER OPT-IN TO OVERDRAFT, BUT STILL RECEIVE AN OVERDRAFT FEE. OPT-IN PROVISIONS ONLY COVER CERTAIN TYPES OF TRANSACTIONS.

Part of the problem is that new regulations did not alter the fact that there are really two regulatory approaches in place for overdraft. A consumer can opt-out of overdraft and still be charged an overdraft fee.

The first system is based upon opting-in for transactions related to non-recurring debit card purchases and ATM withdrawals. Without consumer consent, banks cannot charge a fee to cover an overage.

There is another approach that governs overdraft re-

lated to checks, recurring ACHs, and automatic bill payments. In these situations, banks may charge a fee at their discretion. Consumer consent is not necessary.

Some banks will not offer overdraft - regardless of consumer consent - for debit and ATM overages. In establishing this practice, those institutions give up substantial revenue opportunities. Not surprisingly, they are the exception to the rule.

Opt-in rules only apply to the first group of payment instruments. Many consumers fail to understand this practice. The following comment submitted by Ally Bank customer to the CFPB underscores that situation:

I contacted Ally Bank about how to opt out of having the bank cover an overdraft with an ATM fee and thus opt out of related fees. They told me there is no way to opt-out of having the transaction covered (and also told me there would be a fee.) This seems to contradict the law.

The meaning of opt-in is not clear.

Regulators are making efforts to onboard more people to the banking system. But until overdraft is addressed, it will have an effect that is opposite and stronger than any inclusion-focused initiative. Consider this consumer comment:

Bank of America constantly adds fees before I can correct the issue. I am living almost check to check. So when I do get the money to fix the problem I get hit with more fees which make it

worse. *This problem is so bad that I closed my account.*

In more than 13 percent of overdraft-related complaint narratives released by the CFPB since March 1st, consumers protested that they were charged an overdraft fee even though they had opted-out of the service.

We advocate for a system that prohibits overdraft in certain instances and applies safeguards to protect consumers in other cases.

But given that the decision to honor a check is made without a means to verify a balance, the best option is to strengthen the rights of consumers.

The current legal framework around overdraft leaves it up to banks to make their own determination about how they structure their overdraft programs. This is a legal practice - and that is a problem. Without this regulatory opening, the current scale of overdraft could never occur.

FREQUENT OVERDRAFTERS WERE MORE LIKELY TO EARN LESS THAN \$30,000 PER YEAR, TO HAVE LESS THAN A COLLEGE EDUCATION, AND TO HAVE MADE A DRAW AGAINST THEIR RETIREMENT PLAN.

As policy makers refine their thinking about overdraft, it is important to keep in mind the variety and scope

of the functionalities of the checking account product.

Consumers can spend or receive money through recurring and non-recurring outbound and inbound ACH. Consumers may use their routing numbers to allow third-parties to debit their accounts. Consumers can deposit at a branch, through the mail, at an ATM, or with their smart phone. Consumers can authorize transfers between their own accounts and between accounts in their name at different banks. They can send and receive wire transfers.

Banks offer regular checks, cashier checks, and pre-authorized checks. Recipients of those payments can deposit them one at a time, but some may want to use batch processing or remote capture to expedite the processing of those checks.

Already, many banks are venturing into offering a variety of mobile payment options, virtual wallets, external transfers via email and texts, and remote deposits.

Adding to the complexity are the variety of procedures aimed at conforming to regulatory compliance standards and security concerns. Banks must design their accounts to meet the rules of a variety of payments laws. They must build safeguards to defend against fraud.

Fees for those services can vary depending upon frequency of use, a consumer's account status, the location of the transaction, or other factors that must be

sensitive to account maintenance.

All of this underscores the complexity associated with the modern checking account. New technology must co-exist with legacy systems. That challenge is only growing, as many innovations only serve to increase the universe of payment functionality.

Of all the options currently in use, checks may be the most problematic. Many overdraft events would never occur were it the case that all transactions were time-stamped. In the near future, the Federal Reserve may re-orient the payments system to near-real time activity. Until then, policy makers must address the risks they create.

The regulatory solution is to establish an updated overdraft regime centered upon the principles of simplicity and uniformity.

PREVIOUS RESEARCH

Advocates, industry associations, and regulators have already produced a great deal of research on the consumer experience of overdraft.

In 2014, the Pew Charitable Trusts published “*Overdrawn: Persistent Confusion and Concern about Bank Overdraft Policies*,¹” which documented how little consumers understood about the overdraft service. After surveying 1,804 consumers, Pew found that most over-

1 http://www.pewtrusts.org/~media/Assets/2014/06/26/Safe_Checking_Overdraft_Survey_Report.pdf

draft users would have preferred to decline some of the transactions that were covered. Moreover, it said that one in ten Americans with overdraft did not realize that they had signed up for the service. The report also captured demographic data. Their analysis revealed that overdraft users were disproportionately younger, more likely to earn less than \$100,000, non-white, and without a credit card. Additionally, Pew found that 52 percent of those who opted-in did not recall doing so².

This followed “CFPB Study of Overdraft Programs,” a 2013 white paper from the Consumer Financial Protection Bureau that outlined findings from the Bureau’s initial research on the topic. The white paper took advantage of the CFPB’s access to consumer data. Echoing earlier work, the CFPB noted that a small subset of account holders received the majority of overdrafts.

Results from a 2012 survey by the Independent Community Bankers Association of America went into greater detail about the makeup of consumers who received more than six overdrafts (the segment with highest usage of overdraft). According to the ICBA, frequent overdrafters were more likely to earn less than \$30,000 per year, to have less than a college education, and to have made a draw against their retirement plan³. The group making at least four overdrafts per year was similarly weighted toward lower-income households and those

2 <http://www.pewtrusts.org/en/research-and-analysis/reports/2014/06/26/overdrawn-consumer-experiences-with-overdraft>

3 <https://www.icba.org/files/ICBASites/PDFs/2012OverdraftStudyFinalReport.pdf>

without post-secondary education⁴.

By contrast, upper-income consumers were far more likely to benefit from an offer by a financial institution to have an overdraft fee waived as a courtesy.

THE FDIC FOUND THAT ONE IN THREE UNBANKED HOUSEHOLDS SAID THAT HIGH OR UNPREDICTABLE FEES WERE A REASON THEY NO LONGER HAD A BANK ACCOUNT.

In the same year, the Consumer Federation of America sorted overdraft costs by checking account balance. Cross-tabbing consumers by two variables – balance and overdraft frequency – CFA found that lower wealth households were 15 times more likely to have received an overdraft fee in the previous two years. As well, they noted that the cost paid by consumers for checking accounts was dependent upon meeting balance waivers: only 6 of 61 basic accounts were free without meeting waiver terms⁵.

Together, these findings underscore how the least fortunate pay a disproportionate burden for the overall cost of our payments system. It appears that their experiences have the collective effect of moving more people away from participation in the formal banking system.

The FDIC’s National Survey of Underbanked and Un-

4 <https://www.icba.org/files/ICBASites/PDFs/2012OverdraftStudyFinalReport.pdf>

5 <http://consumerfed.org/pdfs/CanConsumersAvoid-CheckingFees10.16.12.pdf>

banked Households (2009, 2011, and 2013) has highlighted how costly overdraft episodes provoke consumers to leave the banking system. One-third of formerly banked consumers reported that overdraft fees contributed to their decision to close an account. The CFPB found that overdrafts were a factor in sixty percent of instances when a bank closed an account due to a negative balance.

In 2015, four regional advocacy groups jointly issued “*How Banks Sell Overdraft: Results of Mystery Shopping in Four States*,” which found that consumers were very confused about the terms of their overdraft product. This report was unique for its use of mystery secret-shopper tests. Results from those tests documented disparities and inaccuracies in how banks explained the service. Additionally, the research concluded that many consumers did not understand the opt-in process. Some thought they were required to take the service as part of a checking account. Few understood that they could still receive an overdraft even if they did not opt-in. These events can occur with transactions made with checks or ACH.

CAVEATS

Several contexts should be mentioned in order to qualify the the meaning of this paper’s findings.

First, the use of “sweeps” alters the absolute sums of dollars in consumer deposit accounts. A sweep is a

term to describe when a bank moves funds between accounts held by the same depositor. A sweep is not a description for what happens when a bank moves funds as part of an “overdraft service,” where a linked account is pulled to cover an overage.

A sweep may occur to maximize yield or to better match the sum of deposits to the limits of FDIC insurance protection. For example, a consumer could use a sweep to move unutilized deposits in non or low-interest bearing accounts over to ones that pay more in interest. Others will ask for the service when their balances are in excess of maximums for FDIC insurance. Currently, the FDIC will insure only the first \$250,000 of any account balance.

The net effect of that is to increase our output esti-

mates on overdraft fees per \$1,000 (as expressed in Chart One). Nonetheless, most institutions are likely to sweep at roughly the same rate. Therefore, while there is most likely a change in magnitude in sums of deposits, it is probably not the case that there is a corresponding impact on the rank order among banks.

The impact is further qualified by the makeup of overdrafters. A sweep is not a service that is commonly used by a low-wealth household. There are no low-wealth households with more than \$250,000 in non-interest bearing checking accounts. Similarly, the motive to sweep for more interest is generally appreciated by account holders who maintain higher balances.

This data excludes overdraft fees charged for accounts designated for use by small businesses. Still,

TABLE 1: BANKS EARNING THE MOST FROM OVERDRAFT FEES

NAME	\$Q1	\$Q2	TOTAL (IN MILLIONS OF \$)
JPMORGAN CHASE	415	456	871
BANK OF AMERICA	371	397	768
WELLS FARGO	355	401	756
TD BANK	103	115	218
U.S. BANK	98	109	207
REGIONS	77	86	163
PNC	88	85	162
SUNTRUST	69	75	144
BB & T	52	59	111
WOODFOREST	43	45	88
CAPITAL ONE	37	40	77

SOURCE: FFIEC CALL REPORTS

Sums of deposits in millions of dollars; only includes deposits held in transaction accounts designed for use by individuals, households and families. (No money markets, savings accounts, business accounts, sweeps accounts)

the data would capture small business relationships that utilize a transaction account intended for consumers. The net effect is to minimize the absolute sum of overdraft fees.

The overdraft fees reported here do not include those levied for extended overdrafts. Under the accounting rules in the FFIEC's call reports, banks report those fees as interest income. The net effect is to artificially lower the total sum of fees reported by this paper.

MANY BILLIONS PER YEAR; MORE THAN \$1 MILLION PER HOUR

Overdraft fees exceeded five billion dollars during the first six months of 2015. Those sums were paid by consumers who are likely to be less well off. In the end, these costs will drive some of them away from the formal banking system.

Data used in **TABLE 1** identifies sums for overdrafts levied on “transaction and non-transaction savings account deposit products intended primarily for individuals for personal, household, or family use.” This means that these sums exclude fees paid by businesses.

While it is not surprising that the three largest banks would also be the ones that record the most overdraft revenue, others are unanticipated. In particular, the presence of Woodforest National Bank in the top ten

on an absolute basis should trigger concerns.

There are many ways to influence overdraft-related revenues. Some banks choose to create complicated overdraft products that maximize their profits, but others do the opposite. Consumers who bank at the first group of financial institutions pay far more than do those in the latter group, even though both receive essentially the same benefit.

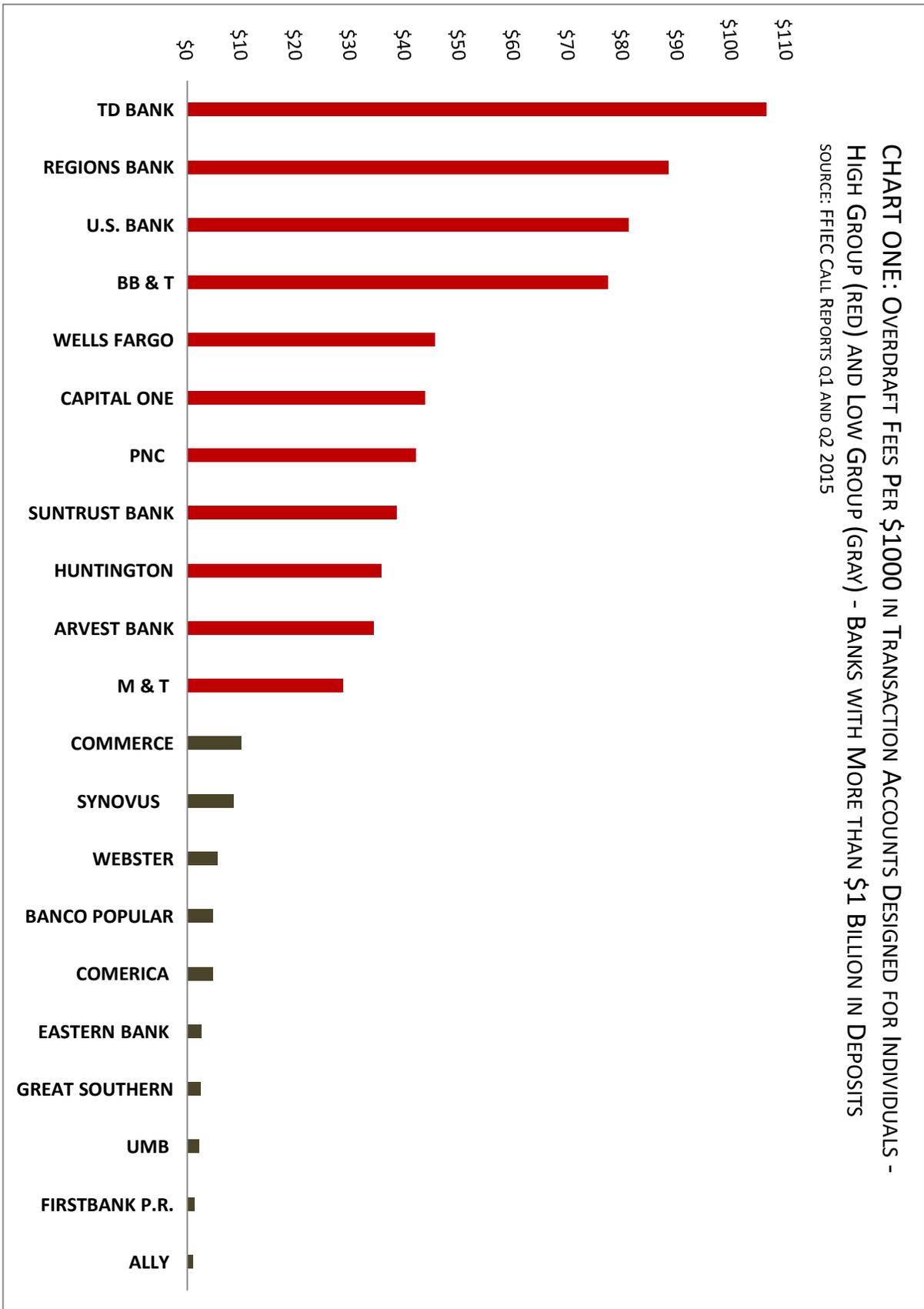
AFTER CONTROLLING FOR DEPOSIT BASE, THERE IS STILL GREAT VARIATION IN FEE REVENUES ACROSS DIFFERENT BANKS

How can banks demonstrate such great variation in the rate of overdraft services utilized by their customers? In a population group as large as U.S. checking account holders, consumer preferences should be fairly consistent across different regions and at different banks. In spite of that, some banks are able to generate overdrafts much more frequently. Our analysis is that these differences can be attributed to variations in how banks design the rules of their transaction accounts.

OVERDRAFT IS NOT A HOMOGENOUS PRODUCT: ITS TERMS AND FEATURES DIFFER EVERYWHERE

CHART 1 details the differences in consumer expense, after accounting for differences in deposit holdings

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across different institutions. The chart reviews how much consumers spent on overdraft fees during the last six months on a bank-by-bank basis. To add clarity, the chart separates banks into high and low categories. Institutions that fell in the middle were not included. The chart's threshold for "high" is set at thirty dollars over six months and the threshold for "low" is at or below ten dollars.

THE CFPB FOUND THAT WHILE THE MEDIAN OVERDRAFT FEE WAS \$35, THE AVERAGE COST OF AN "OVERDRAFT EVENT" WAS \$69.

This chart uses data from the FFIEC that provides information on transaction account balances for accounts held by individual households. This data excludes savings accounts or any funds associated with business accounts. We average overdraft charges per \$1,000 in balances. [See page 9, "Caveats"] This creates a unit level that is equal across institutions. Only banks holding deposits of more than \$1 billion in accounts designed for individuals (both interest-bearing and non-interest bearing) were included in this chart.

As the chart reveals, the differences can be dramatic. This chart excludes many smaller banks. However, some smaller banks do have overdraft rates per \$1,000 in deposits that are much higher: This includes Woodforest National Bank (\$462 in fees per \$1,000 in deposits), Trustmark (\$91), BankPlus (\$163), and First Guaranty Bank (\$333).

The CFPB has itself noted the degree of variation in opt-in rates across different financial institutions. Its white paper noted that opt-in rates by new account holders varied from just a few percentage points to more than 40 percent⁶.

There are also incidents where programs go beyond what is legal. The CFPB has issued a number of enforcement actions against banks for illegal overdraft practices. But many harmful practices can take place within the boundaries of the law. To see how legal practices have still hurt consumers, review the narrative comments in the Appendix at the end of this paper.

EXPENSES DIFFER BECAUSE BANK POLICIES DIFFER

The CFPB found that while the median overdraft fee was \$35, the average cost of an "overdraft event" was \$69⁷.

This is a notable finding, because it underscores that an overage typically creates multiple overdraft fees. There is a cascading dynamic that mirrors the "debt trap."

What levers can banks utilize to maximize or minimize the cost of overdraft for consumers?

Banks have all kinds of tools at their disposal to har-

⁶ http://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf

⁷ <http://www.pewtrusts.org/en/research-and-analysis/reports/2014/06/26/overdrawn-consumer-experiences-with-overdraft>

vest more overdraft revenue from their deposit accounts. Understanding this is essential to seeing how consumers' overdraft costs could vary so much.

Many of those tools are not immediately obvious - even if the impact of their terms is very significant.

CHART TWO reveals the great variety in overdraft features across different banks. It tracks the standard overdraft fee (solid bar), maximum number of overdraft fees charged per day (striped bar) and dollar amount of overage cushion (dotted line starting from the right axis).

Below are the policies that affect overdraft frequency and overall cost per overage episode. It is supplemented with examples from specific banks.

Differences in Maximum Number of Overdrafts Fifth Third charges up to ten overdrafts in one day. If Fifth Third covered ten transactions, then the consumer would owe \$362. (Fifth Third charges \$33 for the first two overdrafts in any twelve-month period, but then \$37 for each subsequent overdraft)⁸. RBS Citizens will place up to seven overdraft charges on an account within 24 hours. BB&T, SunTrust, Regions, and Compass will all go as high as six. Bancorp South says it limits overdraft fees to eight per day. While Arvest levies a relatively low fee - just \$17 per overdraft - it will debit an account as many as eight

times in a single day.

Banks charge insufficient fees funds ("NSF") on top of overdraft fees. Regions Bank will charge six overdraft fees per day, but it warns in its disclosure that it may also levy as many as six additional NSF fees⁹. U.S. Bank indicates that its four overdraft fees can be followed by as many as four more NSF fees. Regions will debit an account for an overdraft fee as many as six times per day. Regions will also charge up to six insufficient funds fees, each for an additional \$36. While TCF gives consumers a \$5 cushion, it levies an NSF fee for any overage.

FORTY-FOUR PERCENT OF OVERDRAFT-ENABLED ACCOUNTS HAD TEN OR MORE OVERDRAFTS IN THE PREVIOUS TWELVE MONTHS

Clearing on a per-transaction basis versus clearing at the end of the business day: Ally, Schwab, and HSBC use a system that can only result in one fee per day. For those banks, it is not a moment-in-time overage that triggers a fee, but rather an overage after all debits and credits have been processed. They are the exception. Most banks utilize a per-payment approach. The following is a comment made by a consumer to the CFPB:

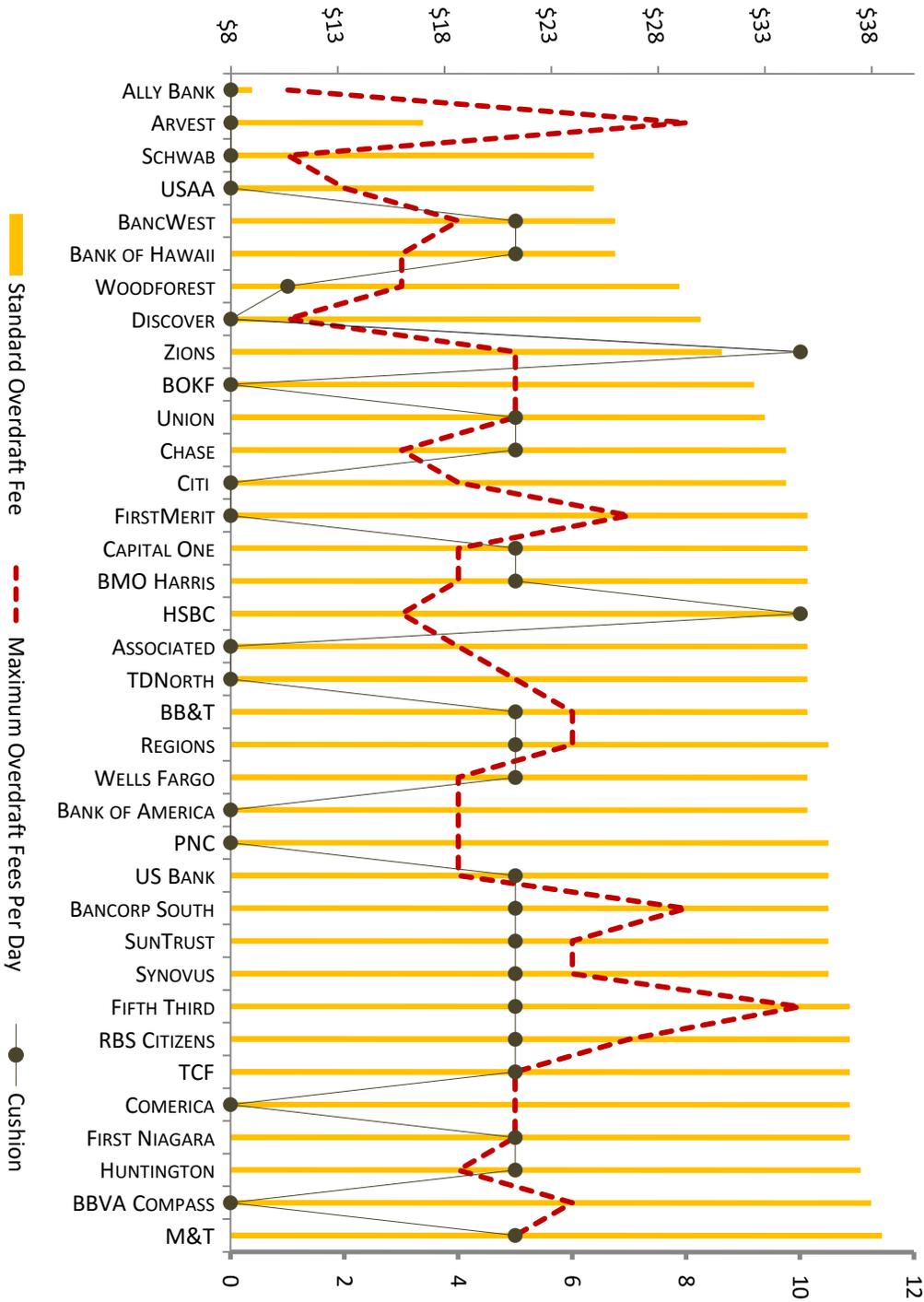
"TCF Bank charged my account an overdraft fee to-

⁸ https://www.53.com/doc/pe/pe-od-coverage-agreement_0510.pdf

⁹ http://www.regions.com/virtualDocuments/Overdrafts_OverdraftFees.pdf

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CHART TWO: VARIATION IN OVERDRAFT SERVICE CHARGE FEES, DAILY SERVICE MAXIMUMS, & OVERAGE CUSHIONS



taling \$180. How can they charge an overdraft fee for each small purchase around \$5.00? Is it not more reasonable to charge an overdraft fee to your account at midnight if your account is overdraft rather than charging \$35.00 on every small transaction that happened in the day?"

Applying an overdraft fee when a business day ends in an overage costs a consumer less than does a system that imposes penalties on a per-transaction basis. The former is better for consumers and the latter is better for banks.

The lack of an overage cushion: A cushion is a policy that allows a slight overage without a fee. In reviewing the published fee schedules of 39 different banks, we saw substantial variety. Fifteen institutions offered no cushion at all. Nineteen employed a five dollar cushion. One had a one dollar cushion. Two offered a ten dollar threshold. Although the price for an overdraft at TD Bank is equivalent to the market average, it generates a high rate of fees. That may be attributed to its practice of not providing an overage cushion.

Charging an extended overdraft fee: This add-on fee is another powerful factor. Some banks elect to charge a fee when an account remains in deficit for a sustained period of time. Usually the period required to trigger an extended overdraft fee is relatively short. Of the 39 institutions, 26 had some kind of an extended overdraft fee. Following the comment in the previous section, TD

Bank has one of the highest extended overdraft fees.

High-to-low check order sequencing: Banks can choose the order in which they post debits for non-time-stamped transactions, such as checks and ACH debits. This is another area of great variation. In a 2014 survey of checking accounts at 44 banks, Pew concluded that 22 were using low-to-high and several offered a modified version of low-to-high, but some still lagged.

APPLYING AN OVERDRAFT FEE WHEN A BUSINESS DAY ENDS IN AN OVERAGE COSTS THE CONSUMER LESS THAN DOES A SYSTEM THAT IMPOSE PENALTIES ON A PER-TRANSACTION BASIS. THE FORMER IS BETTER FOR CONSUMERS, BUT THE LATTER IS BETTER FOR BANKS.

Posting Order: In its white paper, the CFPB noted that banks differed in how they ordered the booking of debits and credits. The paper said that while it was the norm for institutions to record credits prior to debits during end-of-business-day processing, there were still variations across different banks. Some used high-to-low debit sequences. The ICBA's 2012 study of its member banks found the same practice to be the case among all but a few small banks. Post ordering is very complicated. Consider this approach from one national bank:

- a) Add deposits
- b) subtract time-stamped debits

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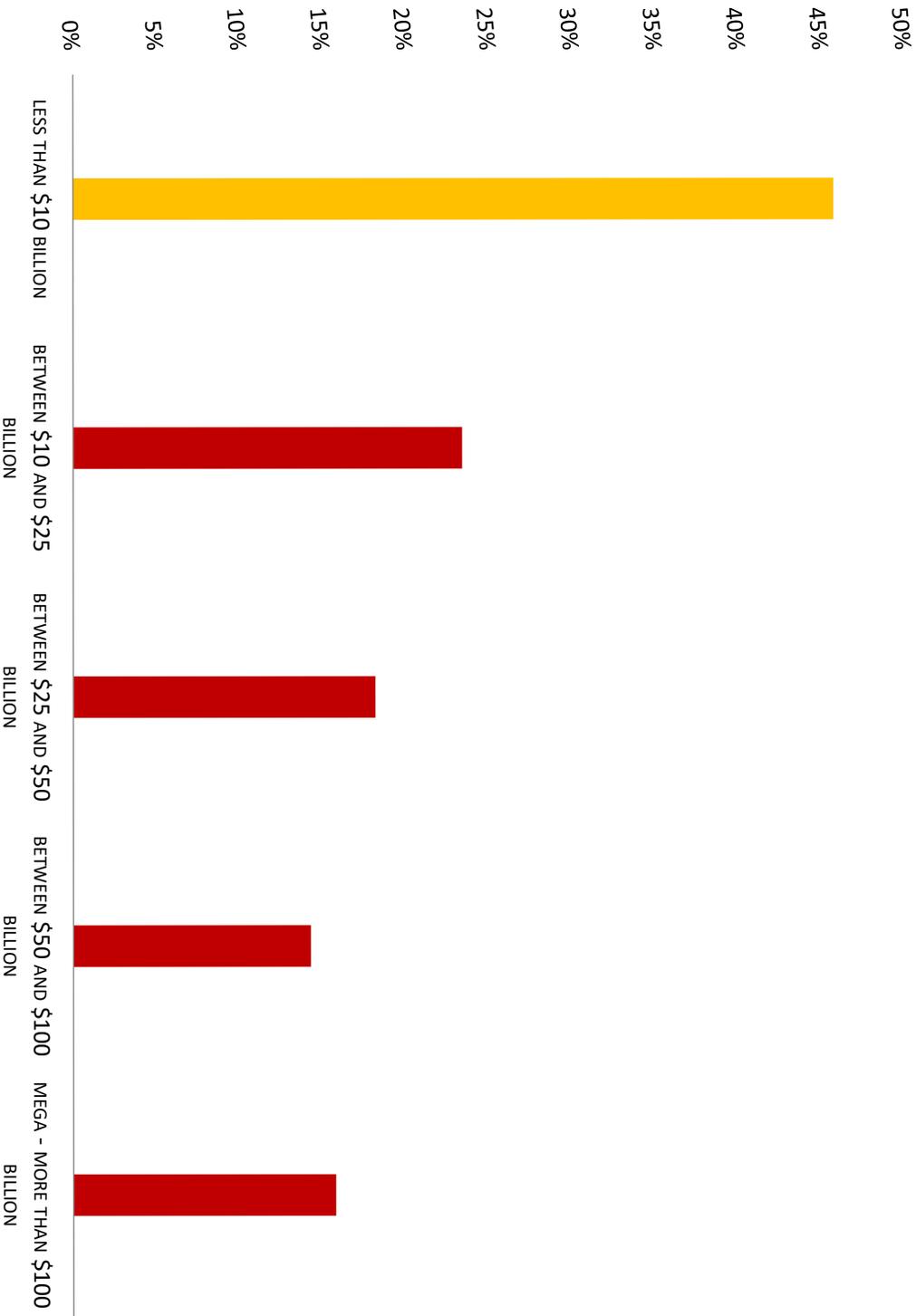


CHART THREE: SHARE OF BANKS IN EACH ASSET SIZE CATEGORY WHERE OVERDRAFT FEE REVENUE IS MORE THAN 10 PERCENT OF NON-INTEREST INCOME
MOST OFTEN THE CASE AT SMALL BANKS
From FFIEC Call Reports: Q1 2015

(wire transfers, everyday debit card purchases, online banking purchases, ATM withdrawals, teller cash withdrawals, and checks presented to a teller) in chronological order: c) Then debit non-time stamped items (checks and ACH) on a high-to-low basis.

Charging overdraft on ATM withdrawals and non-recurring debit purchases:

Banks can choose when they apply overdraft. It is technically possible to not cover overages on non-recurring debit and ATM withdrawals, as these are real-time electronic payments. Most banks still include these types of overdraft events under an opt-in framework. Thus, if a consumer asks, some banks will cover the payment for an overdraft fee.

When banks make it harder to overdraft, the sum of revenues derived from the service decline. As evidenced in **CHART ONE**, Bank of America does not fall in the high tier. Bank of America has been intentional about developing policies that reduce the rate of overdrafts. It does not cover non-recurring debit transactions or overages at ATMs¹⁰. The maximum daily overdraft volume is held to four per account. Ultimately, these policies translate into lower revenues on transaction accounts. Only about 30 percent of Bank of America's revenues from this area were derived from overdraft. By contrast, at US Bank, almost seventy percent came from overdraft during this period of time.

Other banks with this policy include Ally Bank¹¹, Arvest

10 <https://www.bankofamerica.com/deposits/manage/faq-overdraft-services.go>

11 <https://www.ally.com/resources/pdf/bank/ally-bank->

Bank¹², and HSBC.¹³ But unfortunately, these institutions are exceptions to the norm.

OVERDRAFT SUBSIDIZES CHECKING

There are several large banks where more than sixty percent of all revenues from deposit accounts came through overdraft charges.

TABLE 2 details the degree to which larger banks (more than \$10 billion in assets) use overdraft to generate revenue from deposit accounts.

At TCF National Bank, an institution with \$19.8 billion in assets, overdraft fees accounted for three-quarters of all revenues derived from deposit accounts.

The co-incidence of high overdraft revenues and bank-chosen overdraft polices at TCF National Bank underscore the assertion of this paper: the details within an overdraft policy can mask the true cost of the product, usually in ways that increase costs for consumers. TCF has one of the least forgiving overdraft products. While it does offer a five dollar cushion, TCF charges an overdraft fee of \$37. However, further policies are well outside the norm. Chief of these is TCF's extended overdraft fee. TCF begins to make additional charges on the very next day. In their TCF Choice Checking account, an additional \$28 fee is levied for each of the next five days. Thus, a consumer could pay \$177 within

straight-talk-product-guide.pdf

12 <https://www.arvest.com/personal/bank/checking/overdraft-coverage-options/what-you-need-to-know-about-overdrafts>

13 https://www.banking.us.hsbc.com/personal/deposits/chking_tcs.pdf

TABLE 2: SHARE OF TRANSACTION ACCOUNT REVENUES (“TAR”) GENERATED FROM OVERDRAFT

INSTITUTION	DEPOSITS \$	TAR \$	OD FEES \$	OD/TAR%
GREAT SOUTHERN	1,315	4.8	3.2	67.5
ARVEST	1,194	65	41	63.3
BANCORPSOUTH	1,284	25	14	57.5
ALLY	1,137	2.4	1.3	53.3
REGIONS	1,848	352	163	46.4
FIRST-CITIZENS	1,291	44	20	46
CAPITAL ONE	1,773	171	77	45.3
TD	2,055	493	218	44.3
SUNTRUST	3,741	326	144	44.4
RBS	2,695	168	67	40.0
JPMORGAN CHASE	40,256	2,184	871	39.9
HUNTINGTON	1,295	117	46	39.6
BB&T	1,438	300	111	37.0
EASTERN	1,455	11	4	35
M&T	2,004	165	57	34.7
US BANK	2,564	615	207	33.8
SYNOVUS	1,500	39	13	33.0
COMMERCE	1,202	38	12	31
PNC	3,868	544	162	30

SOURCE: FFIEC, TABLES RIADH032, RIADH033, RIADH034, RCONP753, RCONP754, RCONP754, QUARTER 1 AND 2 OF 2015. SUMS IN MILLIONS OF DOLLARS. INCLUDES ONLY INSTITUTIONS WITH WITH DEPOSITS OF MORE THAN \$1 BILLION. DEPOSITS ARE FROM INTEREST BEARING AND NON-INTEREST BEARING TRANSACTION ACCOUNTS DESIGNATED FOR NON-BUSINESS CONSUMER HOUSEHOLDS

five days after making one overage of more than five dollars. With accounts other than Choice, while the extended overdraft fee is triggered less frequently, the overage is only one dollar.

Nationally, only about one in six households choose to opt-in for overdraft coverage. The CFPB, in its 2014

white paper on overdraft, noted that only 27 percent of accounts had an overdraft in the previous year. However, of those that did have one, the average cost of the fees paid by the account holder over the course of the entire year was \$227. Forty-four percent of overdraft-enabled accounts had ten or more overdrafts.

One concern about overdraft is its potential to force the overall costs of checking upon lower wealth consumers. Those households tend to have less wealth and are more likely to be members of a minority group.

SMALL BANKS ARE MORE LIKELY TO GAIN FROM OVER-DRAFTING

There are more than a few small banks (assets less than \$10 billion) who derive a high share of their revenues from overdraft fees. Certainly there are exceptions, but when banks are divided by size it appears that the smaller institutions are more reliant on this product for their incomes. **CHART 3** divides overdraft fees charged to households against the overall non-interest income reported by the bank during the first quarter of 2015.

EXAMPLE: WOODFOREST NATIONAL BANK

As an institution that focuses upon deposit services, Woodforest National Bank's income statement evidences how a product that appears to be an extra feature can be a prime driver of the overall business. At Woodforest, fees charged by overdraft actually exceed net income for the entire institution - and by a very large margin.

TABLE 3 shows their results for the first six months of 2015. During that period, overdraft fees were many times their net income.

Most mid-size and large-size banks do come close to serving many strata within their communities. But there are exceptions. Issuers who focus on credit or

TABLE 3: DEPOSIT SERVICES REVENUE & NET INCOME AT WOODFOREST NATIONAL BANK

	Q1	Q2
REVENUES		
OVERDRAFT	\$42.69	\$44.97
MAINTENANCE	\$8.15	\$8.50
ATM	\$7.11	\$7.35
OTHER	\$1.51	\$1.43
TOTAL REVENUES	\$59.46	\$62.26
TOTAL DEPOSITS	\$205.7	\$173.2
NET INCOME		
NET INCOME	18.82	37.23
OVERDRAFT/NET INCOME	227%	244%

FFIEC CALL REPORTS: RIADH032-35 AND RIAD4340 FOR 3/31/2015 AND 6/30/2015. SUMS IN MILLIONS OF DOLLARS. DEPOSIT ACCOUNTS INTENDED FOR USE BY INDIVIDUAL, FAMILY AND HOUSEHOLD CONSUMERS.

prepaid cards (Department Store National Bank or Green Dot Bank) are examples. Woodforest, where the majority of branches are sited in Wal-Marts, falls into this category. Advertising Age recently released data which estimated that the average income of a Wal-Mart shopper was \$41,841¹⁴. But the income distribution skewed downward. Almost half of those consumers reported incomes below \$35,000. This is below the national median. It is also draws from the same income groups identified by the ICBA as most likely to pay more than four overdrafts in a particular year.

AT MANY SMALL BANKS, TOP-LINE OVERDRAFT REVENUES EXCEED BOTTOM LINE NET INCOME

Woodforest's fee schedule would generally suggest that the bank does not have an aggressive approach to overdrafting. The Texas-based bank charges \$29 for an overdraft¹⁵ - a sum that is actually lower than many of the larger banks. Likewise, the bank will only allow a consumer to register three overdraft fees in any one day. But notably, there is one way that Woodforest is unusually aggressive relative to other banks: their checking accounts have a one dollar cushion. As a result, many of their overdrafts may be the product of very small overages.

Thus, this supports this paper's contention that terms are as much if not more significant to consumer cost

as is the actual price of the fee. Woodforest has a low fee, but it generates very high overdraft revenues relative to its deposit base.

Woodforest is an extreme example, but many other smaller banks also have rates of overdraft that are equivalent to or even greater than some of the larger institutions mentioned earlier in this report.

CONCLUSION

This research shows that even after regulatory reform, sizable sums of money are still being charged to consumer for overdraft fees.

A fundamental problem is that consumers have no ability to pick and choose from the variety of overdraft services. In other markets, consumers can make a la carte selections. With checking accounts, they do not have the same opportunity. Consumer choice is enhanced with simplicity. To that point, we need to have less variation in product design.

We believe that a better approach pulls from both regulatory prohibitions and product reforms. This reflects the multiple contexts within which overdrafts can occur. In certain payment modes, transactions can be canceled before an overage occurs. These instances - such as a withdrawal at an ATM or a swipe purchase inside a store - can instead be declined.

We believe that the CFPB should prohibit overdraft fees for overages from non-recurring debit card charges and at ATMs.

14 http://adage.com/images/random/walmart_avecust.pdf

15 <http://www.woodforest.com/uploadedFiles/Account-Disclosures/A-9-WNB.pdf>

Unfortunately, checks and ACH debits do not have the same flexibility. In these contexts, our policy approach would shift and focus upon a system that shields consumers from excessive harm.

This begins with re-thinking when overdrafts take place. Overdraft fees should be triggered not on a per-transaction basis, but only when an account ends up negative after the end of the business day.

To do that optimally, regulators should establish a uniform system where checks, ACHs, billpays and other non-time-stamped transactions clear on a “credits-first, debits-second” schedule.

To make a uniform post-order system that is truly consumer-friendly, high-to-low check sequencing should be prohibited.

Extended overdraft fees should be prohibited. Once a consumer’s account balance has fallen below zero, banks should be prevented from pushing those consumers further into debt. This means no cascading fees. Consumers should never pay more than once for the service of having a payment covered.

Sometimes banks add NSF fees in addition to overdraft fees. One should exclude the other: either charge an overdraft fee or an NSF fee, but not both.

The evidence of widespread customer confusion should not lead to the conclusion that policy makers need to design better disclosures. The problem is not

that existing disclosures are incomprehensible, but instead that the design of overdraft product itself is far too complicated.

Some consumers may over-spend repeatedly. These individuals are not using overdraft as a means to cover the occasional mistake, but instead as a substitute for a line of credit. For those individuals, overdraft should be defined as credit and regulated accordingly. Once a bank has debited a consumer’s account for six overdraft fees in any twelve-month period, then the account should be reviewed. The lender should underwrite the consumer’s overdraft privileges for his or her ability to repay the debt.

APPENDIX:

WHAT CONSUMERS SAY ABOUT OVERDRAFT; NARRATIVES FROM THE CFPB’S CONSUMER COMPLAINT DATABASE

March 20th, 2015: Consumer does not understand that opting-out of ATM and debit overdraft does not extend to canceling overdraft on other payment categories. Consumer is charged on overdraft fee and subsequently, the same consumer is charged additional extended overdraft fees.

“An unexpected charge hit my account on along with other expected transactions. I checked online before making the transaction and my available balance was

enough to cover the transactions I put through. TCF then charged me overdraft fees over the transactions. Had the transaction not been applied to my account I would have had sufficient funds to cover the other transactions ... I have had problems with overdraft fees before; on multiple occasions I have been told overdraft protection was turned off only to have a transaction slip through anyway. I have repeatedly asked to have overdraft protection removed from my account so this would stop happening but they keep re-enabling it without notifying me or getting my permission. The transaction should have been declined, instead TCF allowed it to post and then stacked overdraft fees on top of it.”

Result: Closed with explanation. By law, TCF is able to make these charges. The customer was confused about the limited scope of the opt-in provision.

April 8th, 2015: Consumer does not understand that opting-out of ATM and debit overdraft does not extend to canceling overdraft on other payment categories. Consumer is charged on overdraft fee. Subsequently, the same consumer is charged additional extended overdraft fees.

“When I opened my checking account I specifically stated I did not want them to process any transactions that would send my account into an overdraft status. I

clicked on the “opt-out” link. BB&T allowed many transactions to go through on several occasions which resulted in exorbitant overdraft fees.”

Result: closed with explanation. Under the bifurcated rules of the opt-in process, a bank can charge overdraft fees to consumers who have asked to opt-out of overdraft. Opt-out only covers ATM withdrawals and non-recurring debits.

April 1st, 2015. An overdraft puts a consumer into a cascading cycle of debt. Overdraft fees trigger additional fees for insufficient funds. The consumer’s next deposit does not cover the outstanding debt. As a result, the consumer does not have money for basic necessities.

“I bank with PNC Bank. They continue to take money from my account. I have had \$930 taken in past 2 weeks. I have had XXXX \$36 fees (\$140) totaling \$540 just on the same XXXX checks. These fees include a \$36 overdraft fee and a \$36 return check fee on XXXX separate occasions. They attempted to put the check back through when there was no money to cover them. I have an automatic deposit each week. I looked and the deposit went the through last night for this week and the next day my card was declined. They fabricated XXXX overdraft fees of \$140 which made my account negative by \$88. The account would not be negative if not for

these fees. I cannot pay my utilities. I have children and cannot afford food, electric, or water.”

Result: closed with explanation. While the consumer did pay an exorbitant sum (\$930) in overdraft fees, insufficient funds fees, and extended overdraft fees, the bank debited her account in a legal manner. This result still falls within the terms of PNC's account agreement.

April 4th, 2015: Consumer's debits are ordered incorrectly.

“Chase Bank charged my account \$34 for an NSF fee. The account had a balance of \$780 and two debits came in. One for \$100 and the other for \$1000. Chase paid the larger item first, thereby allowing them to charge XXXX fees of \$34 each. The \$100 debit should have been paid first and the \$1,000 secondly... Chase paid the larger item first and therefore allowed them to charge XXXX fees of \$34 each. I called and asked Chase to refund the \$34 for the \$100 ACH debit. I was denied.”

Result: closed with monetary relief

August 21st, 2015: Consumer makes several small purchases for a collective total of less than \$10. TD Bank proceeded to process the checks multiple times while simultaneously charging both overdrafts and NSF fees. Since TD Bank offers no overage cushion, a few small

transactions resulted in costs of approximately \$1,200.

“On my check I made a payment for my nephew thinking that I was okay. I forgot that I had sent out some packages through UPS. Well, I ended up going overdrawn, not by a lot. I tried to do these small charges \$2 - \$3 several times and I didn't have enough in my account. Well they were trying every couple of days and the bank was charging me \$35 for every time. When I checked my balance Saturday it was \$1200 overdrawn, I was flabbergasted. So I added up the charges and it came to \$1,200, so that means that I was \$8 overdrawn.”

Result: closed with explanation. Per terms of the account agreement, TD Bank's actions were legally defensible.

September 3rd, 2015: Owing to their lack of an overage cushion, a series of small purchases triggers overdraft fees of \$180. Consumer would prefer that fees from an overage are credited only once, at the close of business and not on a per-transaction basis.

“TCF Bank charged my account an overdraft fee totaling \$180. How can they charge an overdraft fee for each small purchase around \$5? Is it not more reasonable to charge an overdraft fee to your account at midnight if your account is over-drafted rather than charging \$35 on every small transaction

that happened in the day?...I have checking accounts with other banks and when I go overdraft in the day, they send a notification to my email, and regardless of how many transactions I charge to my card they don't charge the overdraft fee of \$35 to my account if I make sure I deposit cash into my checking account before the daily deadline. I have to say that TCF Bank representatives were totally eager and indifferent about charging their customer \$84 for going overdraft by \$10."

Result: Closed with explanation. This is a legal practice which was fully disclosed by TCF in its terms and conditions.

September 3rd, 2015: A consumer assumes that the balance displayed on his consumer account is the actual balance, but then learns that Bank of America maintains a difference method to book transactions:

"My Bank of America checking account was subjected to multiple overdraft charges. This seems to have been caused by the Bank applying the transactions in a manner that maximized the number of transactions subject to an overdraft fee. In addition, while the default display of transactions shows the statement balance, "the bank maintains a separate account balance" that apparently can trigger fees even when the statement balance is showing a positive balance. This

seems misleading at best and deceitful at worst."

Result: Closed with monetary relief

August 21st, 2015: Fifth Third adds a series of extended overdraft fees to an account that has already received overdraft fees:

"My account has been hit with a negative balance fee on top of overdraft fees. My account has been charged with a negative balance service charge which then puts my account in the negative. I am charged an overdraft fee and then I am charged again for a negative balance fee for the same occurrence. I have been double charged for the same overdraft caused by this negative balance fee and then the cycle happens the very next month for having a negative balance. I've been charged nearly XXXX\$ in the last two months alone. This seems very unfair and I feel taken advantage of especially since my personal banking reps had no clue what a negative balance fee was."

Result: Closed with explanation. Without the law, Fifth Third is able to charge extended overdraft fees. In fact, they are able to charge extended overdraft fees on top of previously debited extended overdraft fees. The consumer has fallen into a repeating cycle of debt.

April 30th, 2015: A consumer believes that he has not consented to overdraft and then is surprised that he received an overdraft fee. He checks his balance regu-

larly but he understands that the amount indicated is not consistent with his spending power.

“Wells Fargo is doing the same thing that XXXX did. They are charging overdraft fees without consent. I also believe that they try to make a person have an overdraft fee on purpose just so that they can charge the overdraft fee. I go by my available balance and sometimes my available balance is n’t right which causes the issues.”

Result: Closed with explanation. Although the customer may believe that he has not consented to overdraft, that ability only extends to certain transactions. Wells Fargo is within the boundaries of the law in assessing those fees.

April 29th, 2015: A customer notices that each individual overage has triggered a series of cascading overdraft fees.

“My husband and I had a checking account with Regions Bank and during that time we found that the bank would change the order of our transactions until they were listed in a way that we would overdraft our account multiple times instead of the single overdraft that should have occurred. Sometimes there should have been no overdraft fee at all according to their policy because it would’ve been under \$5, but after the transactions were rearranged there would be multiple overdrafts. Over the span of time we had

this account we were charged thousands of dollars in overdraft fees because of them rearranging the transactions. We have recently found out that this practice is illegal and that Regions bank has been fined for illegal overdraft fees. What can be done about our case? We quit using our account and now my husband has a debt collection against his credit as we refused to pay anymore of their bogus fees.”

Result: closed with explanation. Regions’ terms and conditions disclose these practices.

April 29th, 2015: A consumer never opts-in for overdraft, yet ultimately pays more than \$1,000 in fees.

“Time and time again I told Wells Fargo that I do not wish to opt into their overdraft protection plan, but yet and still I am being charged overdraft fees. As I call and tell them that I have never opt in they say I see that but still I have been charged over \$500.00 in overdraft fees. For one year I was charged \$980.00 and in this year thus far I was charged \$280.00 in overdraft fees, in which I opted out of.”

Result: closed with explanation. The opt-in provisions in Regulation E of the Electronic Funds Transfer Act only apply to certain types of payments.