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CFPB REPORT RAISES CONCERNS ABOUT IMPACT OF OVERDRAFT PRACTICES ON CONSUMERS

Today the Consumer Financial Protection Bureau (CFPB) released a report that raises concerns about the ability of consumers to anticipate and avoid overdraft costs on their checking accounts. The report found wide variations across financial institutions when it comes to the costs and risks of opting in to overdraft coverage. The report also found that consumers who opt in for overdraft coverage end up with higher account fees and more involuntary account closures than consumers who decline to opt in.

OVERDRAFT BY THE NUMBERS

- **61 percent:** Overdraft and non-sufficient funds fees accounted for 61 percent of total consumer deposit account service charges in 2011 among the banks in the CFPB report.
- **\$34:** The median per-item overdraft fee in 2012 at the country's largest depository institutions.
- **\$30:** The median per-item overdraft fee in 2012 at the country's smaller depository institutions.
- **\$225:** The amount in annual fees, on average, for accounts that had at least one overdraft or non-sufficient funds fee in 2011 among banks in the CFPB report.
- **53 percent:** The growth of average monthly consumer checking account payments per household from 2000 to 2011.

BACKGROUND

When consumers try to withdraw more money from their checking accounts than is available, the financial institution can reject the transaction. For certain types of transactions, like checks, the institution generally charges a non-sufficient funds fee. The financial institution can also choose to cover the payment by advancing funds on the consumer's behalf, and generally charges a fixed overdraft fee for doing so.

Overdraft coverage on checking accounts has evolved from manual courtesy programs to automated features that today generate a significant share of revenue for financial institutions. This growth in overall deposit service charges occurred at a time when depository institutions were generally migrating away from monthly fees on checking accounts while consumers were generally increasing their volume of transactions, particularly debit card and ATM transactions.

A 2009 Federal Reserve Board rule required depository institutions to secure affirmative consent (opt in) from accountholders for overdraft coverage of ATM and point-of-sale debit card transactions before the institution could charge overdraft fees. This change became effective for new accounts opened after July 1, 2010, and for existing accounts on August 15, 2010.

Opting-In Puts Consumers at Greater Risk

Today's CFPB report found that new customer opt-in rates varied substantially across institutions. At some banks in 2011, more than 40 percent of all new customers opted in while other banks saw opt-in rates of less than 10 percent.

At the end of 2011, the average opt-in rate for overdraft coverage for all consumers – new accounts and established accounts – was 16 percent. For new accounts, the rate was 22 percent. Meanwhile, 45 percent of heavy overdraft users – defined as consumers incurring more than 10 overdraft or non-sufficient funds transactions in the first half of 2010 – opted in by the end of 2010 after the new federal regulation took effect. But this number varied greatly among the institutions in the report. For heavy overdrafters, the banks with the highest opt-in rates in the study had average rates of 66 percent while the banks with the lowest opt-in rates had average rates of 16 percent.

The report also found that a consumer's decision to opt in may have significant ramifications:

- **Consumers who opt in end up paying higher fees:** The CFPB report looked at previous heavy overdrafters who declined to opt in when the new federal requirements were implemented. The report found that they had lower overdraft and non-sufficient funds costs by not choosing debit and ATM overdraft coverage. Specifically, the report found:
 - Accountholders who were heavy overdrafters in the first half of 2010 and did not opt in reduced their overdraft and non-sufficient funds costs, on average, by more than \$450 during the second half of 2010 (more than \$900 on an annualized basis); and
 - The average checking account fees per accountholder who chose to opt in were \$196 in 2011, while the average fees for those who did not opt in were \$28.
- **Consumers who opt in to overdraft coverage are more likely to end up with involuntary account closures:** Overdrafts are a significant contributor to involuntary account closures at many institutions. Involuntary account closures can be harmful to consumers because they make it harder for a consumer to open another checking account elsewhere. Specifically, the report found:
 - Involuntary closure rates were more than 2.5 times higher for accountholders who had opted in to debit and ATM overdraft coverage.

Overdraft Practices Are Highly Complex for Consumers

The CFPB report raises questions about the ability of consumers to anticipate and avoid overdraft costs. Each institution's overdraft policies, procedures, and practices are highly complex and can be difficult for a consumer to navigate, yet greatly affect whether and how often they will incur overdraft fees. These complexities include:

- **Complicated fee structures:** How overdraft charges are incurred varies from institution to institution. Some complications include:
 - The number of overdrafts and non-sufficient funds that can be incurred in a single day. Some institutions, for example, limit the number of overdraft and non-sufficient funds charges in a day to two, others have no cap on fees or allow as many as 12 overdraft and non-sufficient funds fees in a day.
 - Overdraft fees for small dollar amounts. Some institutions charge overdraft fees for any item that overdraws the account by less than \$5 while other institutions charge fees on every overdraft transaction regardless of size.
 - Negative balances. Some institutions charge for extended or sustained negative balances. Others do not.
- **Overdraft coverage limits often depend on many factors:** The overdraft coverage limit is the amount of money the institution is willing to advance to an accountholder when his or her funds are

insufficient to cover a pending payment. Higher limits can result in more overdraft fees because the consumer may keep drawing from his or her account. Lower limits can result in more transactions being rejected and more non-sufficient fund fees. Differences among institutions include:

- Some institutions have a fixed dollar amount for limits;
 - Others vary limits based on each accountholder's individual circumstances, such as a consumer's balance, overdraft history, or deposit patterns.
- **Complex transaction postings:** The order in which check, debit card, and other transactions are posted to an account can influence the number of overdraft fees. If larger transactions are processed first, a consumer is more likely to end up paying multiple overdraft fees on a single day. The report found wide variation in posting practices, including:
 - The debiting of transactions. At some institutions transactions are debited at periodic intervals throughout the day, at others they are debited in nightly batches;
 - How different types of transactions are combined, ordered, and sorted together for processing;
 - The order in which transactions were processed within batches; and
 - When institutions credit and make deposited funds available to their customers.

Costs and Risks Vary By Institution

These different overdraft policies, procedures, and practices lead to very different outcomes for consumers at different financial institutions. This raises questions about some overdraft practices that can be difficult for consumers to navigate. The CFPB report found:

- **Average annual overdraft charges vary among institutions:** The outcomes for consumers varied from institution to institution:
 - The average consumer who overdraws his or her account paid \$225 in overdraft and non-sufficient funds charges over the course of one year;
 - Among the banks in the report, consumers at some paid an average of \$298 while consumers at others paid \$147.
- **Involuntary account closures vary widely:** The different rates of account closures raises questions as to why at some institutions consumers are losing their accounts more frequently than at others.
 - The highest involuntary account closure rate observed in the study was 14 times the involuntary closure rate at the bank with the lowest rate.