



The ICBA Overdraft Payment Services Study

June 2012

Executive Summary

Increased regulatory scrutiny of consumer overdraft payment programs has affected many aspects of how community banks offer these services to consumers, as well as how they monitor and manage these services. Yet with all of these changes, the regulatory scrutiny continues. The Independent Community Bankers of America, the Nation's Voice for Community Banks®, reached out to community banks to assess their practices regarding overdraft payment services. A separate outreach was also undertaken to gauge consumers' checking account practices and preferences related to overdraft payment services (regardless of financial institution type).

The *ICBA Overdraft Payment Services Study* (the Study) is the result of those efforts. To help determine demand for these offerings, ICBA conducted a survey of 3,000 consumers (representing a random sampling of the U.S. banking population). This consumer survey revealed seven key findings:

- **Most consumers understand the potential consequences of returned payments and want important transactions paid by their financial institution (all fees being equal) even if those transactions result in an overdraft.**
- **Consumers using overdraft payment programs are among the most knowledgeable of alternative services to avoid overdrafts.**
- **Consumers who use overdraft payment programs prefer them to other short-term funding options.**
- **Most consumers avoided overdrafts in the previous 12 months.**
- **Frequent account monitoring does not deter overdrafts.**
- **Consumers who use overdraft services are more likely to take out a payday loan.**
- **A consumer's choice of financial institution makes a difference.**

Additionally, ICBA conducted a survey of 575 community banks to help shed light on how community banks manage consumer overdraft payment services, how they control their risk exposure to overdrawn accounts, and whether they meet the account overdraft coverage needs of their customers. Among that survey's notable findings:

- **Community banks are transparent in their disclosures regarding features of their overdraft payment programs and inform customers of alternative services.**
- **Community banks have policies and practices in place to manage their risk and ensure safety and soundness.**
- **Community banks structure transaction posting to minimize potential consumer overdrafts and the related fees.**

- **Community banks provide reasonable overdraft fees and *de minimis* waivers to avoid excessive fees.**
- **Increased regulatory scrutiny during the past two years has limited community bank overdraft income.**

It is our hope that the Study, and the findings contained herein, will help further regulatory understanding about overdraft payment services, how they are used and perceived by consumers, and how they are managed and administered by community banks.

ICBA Recommendations for Overdraft Regulatory Policy

Regulatory policy and oversight should not impede community banks' ability to offer a variety of overdraft payment services to meet their customers' financial needs.

The Study found that most community banks offer one or more services to help their customers avoid returned items, including overdraft payment and alternative services. Community banks disclose terms and conditions of their overdraft payment programs and inform their customers of alternatives services at multiple contact points and through a variety of communication channels. Almost every community bank with an automated program informs its customers of overdraft program coverage limits so that the customer is aware of potential liability and can make informed choices.

Consumers must retain the ability to choose overdraft services that best fit their financial needs.

Regulatory policy should emphasize consumer choice so that consumers can choose services that are right for them and avoid being locked into an ill-fitting overdraft payment service or program. Community banks offer an array of overdraft services and assist consumers in finding the right mix of services.

Consumers who choose to opt out of overdraft coverage for check and ACH transactions are free to do so at any point before an overdraft occurs. However, without overdraft coverage the customer is subjected to a greater fee burden which includes returned item fees and collection fees from the merchant/service provider. Consumers should not be burdened with the additional costs associated with a returned item by default when additional costs are easily mitigated by overdraft coverage. When both bank and merchant/payee fees from returned items are considered, requiring existing customers to opt in to check and ACH overdraft coverage will result in more fees, not fewer.

The regulatory environment should distinguish between ad hoc overdraft payment and automated overdraft payment programs.

Most community banks leverage their knowledge and relationship with the customer in making ad hoc overdraft payment decisions or by using hybrid programs that incorporate manual review with automated programs both to assist the customer and manage risk to the bank. Overdraft rules and regulatory oversight should continue to distinguish between automated overdraft programs and the ad hoc or discretionary overdraft coverage rooted in customer knowledge. Unless this distinction is made, any regulation, guidance or oversight targeted towards automated programs will likely apply to ad hoc programs and hamper community banks' ability to serve their customers.

Overdraft regulation must avoid unreasonable and burdensome customer contact requirements.

Community banks promptly notify their customers, usually by mail, each time a fee has been assessed. The notification identifies the date of the transaction, the type of transaction, the overdraft amount, the fee associated with the overdraft and the amount necessary to return the account to a positive balance.

The Study found that nearly half of consumers reporting an overdraft fee in the last 12 months have contacted their financial institution following an overdraft and had a fee waived or reduced. This provides an effective customer-initiated opportunity to discuss suitable alternatives before a customer becomes a frequent overdraft user, making any mandate for the bank to personally call customers (as a result of frequent overdrafts) unnecessary.

Public policy must be crafted carefully to ensure consumers' financial needs are met within the banking system.

Overdraft regulations and public policy must ensure that consumers are not subject to an increase in the number of returned transactions and subsequently forced into more costly non-bank financial services such as payday loans.

Consumer Survey Overview

The consumer findings of the *ICBA Overdraft Payment Services Study* provide a clear understanding of consumers' experiences with overdraft payment services. The Study collected data on consumers' financial habits related to overdraft services, including account monitoring habits, history of overdrafts, overdraft coverage choices, use of alternative services and small-dollar loans, and preferences regarding overdraft transactions.

In September 2011, 3,000 consumers representing a random sample of the U.S. banking population were surveyed online.¹ The survey participants all had checking accounts and banked at a megabank,² regional bank, community bank or credit union.³ Unless stated otherwise, all percentages reported are for all consumers.

Key Consumer Survey Findings

All fees being equal, consumers want important transactions paid even if those transactions result in an overdraft.

Among all consumers, 85.5 percent prefer their financial institution pay at least one important transaction, such as a mortgage or rent payment, car or credit card payment or utility bill, provided a fee of an equal amount would be charged whether the transaction were paid or returned.

Most consumers avoided overdrafts over the previous 12 months.

More than three-quarters of consumers did not incur an overdraft of their account in the previous 12 months. Just under one-quarter of consumers (23.1 percent) report paying either an overdraft or returned item fee in the past 12 months.

Frequent account monitoring does not deter consumer overdrafts.

Frequent account-balance monitoring does not reduce the likelihood of consumers incurring overdrafts. While one-third of consumers review their primary checking account balance at least once daily, 33.4 percent of those consumers report paying an overdraft or returned item fee in the past 12 months.

¹ For further details of survey methodology and respondent demographics, see Appendix A.

² For the purposes of the consumer survey a megabank was defined as a "large bank with nationwide branches."

³ Consumers were also able to select "other," but did not specify type.

Additionally, 86.2 percent of consumers monitor outstanding transactions, yet these consumers experienced no decrease in overdrafts.

Consumers are knowledgeable of alternative services to avoid paying overdraft fees.

Most consumers are aware of alternative services, with 89.7 percent of consumers aware of or using account transfers and 72.1 percent aware of or using lines of credit. Compared to the average consumer, those who reported an overdraft transaction in the previous 12 months are more likely to use alternative services, such as fund transfers from another account or line of credit, to avoid overdraft fees.

Consumers who use overdraft payment programs prefer them to other short-term funding options.

Consumers who use overdraft coverage are more likely to prefer the programs over other options than those who do not use the programs. The average rank among consumers with one to three overdraft transactions in the past 12 months places overdraft coverage fourth, above a credit card cash advance. Most significantly, overdraft coverage is the most preferred option for consumers with four or more overdraft transactions in the past 12 months, with an average rank of first among the seven options, higher even than borrowing from friends and family.

Consumers who use overdraft payment programs are more likely to take out a payday loan.

Among consumers paying an overdraft fee in the past 12 months, nearly 20 percent also report a payday loan. Overall, only 7.2 percent of consumers use payday loan services, while 9 percent have borrowed from their 401(k) or retirement plan.

Consumers' choice of financial institution makes a difference.

With 14.7 percent paying an overdraft fee in the previous 12 months, community bank customers incur overdraft fees less frequently than customers of megabanks (24.3 percent), credit unions (19 percent) and regional banks (18.8 percent). Community bank customers are less likely to opt out of overdraft coverage for check and ACH debit transactions (13.8 percent) and less likely to opt in to coverage for ATM and point-of-sale debit transactions (14.7 percent) than megabank customers (20.3 percent and 18.1 percent, respectively).

Community Bank Survey Overview

The community bank findings of the *ICBA Overdraft Payment Services Study* explain how community banks manage consumer overdraft payment services, how they control their risk exposure to overdrawn accounts and whether they meet the account overdraft coverage needs of their customers. The community bank survey reviews overdraft payment programs, in which the bank analyzes an overdrawn account for payment, and alternative services, in which customers can choose to transfer funds from a designated account or line of credit or to advance funds from a short-term, small-dollar loan to avoid an overdraft. The survey also collects data on management practices, controls used, fees charged, customer usage, customer disclosures and transaction posting order.

Key Community Bank Survey Findings

Community banks effectively disclose the features of their overdraft payment programs and inform customers of alternative services.

All community banks (100 percent) inform their customers about the details of their overdraft payment programs, and the vast majority of community banks (97 percent) inform their customers of alternative services. Community banks deploy various communication channels, such as accounts disclosures, customer contact personnel and statement inserts to inform customers of service alternatives. Among community banks with automated and hybrid programs, 87.6 percent include coverage limits in account disclosures.

Community banks structure transaction posting to minimize the potential for overdrafts and overdraft fees.

The survey results show that community banks' deposit account operations are designed to be fair to their customers and minimize the potential for overdraft fees. Almost all community banks (95 percent) post credits before debits. The vast majority of community banks post credits first, electronic debits next and checks last. When posting checks, most community banks post in either low-to-high transaction amount or in check number order as encouraged by regulators and consumer groups. To further reduce the incidence of overdraft fees, three-quarters of community banks transfer available funds from a customer-enrolled account to prevent the activation of overdraft payment services.

Community banks provide reasonable overdraft fees and *de minimis* waivers to avoid excessive fees for their customers.

When an overdraft does occur, community banks charge a reasonable amount with a mean fee under \$28. Most community banks (78.2 percent) will waive overdraft fees for *de minimis* overdraft amounts under an average *de minimis* threshold of \$15. When consumers use alternative services, community banks charge an average APR of 15.9 percent for a line of credit and 18 percent for a deposit advance loan.

New regulation and supervisory guidance issued during the past two years have limited community banks' overdraft income.

During the past two years, a new regulation and supervisory guidance were issued to offer additional consumer protections for overdraft payments services.⁴ Since these requirements went into effect very few community banks have reported increased overdraft income.

Community banks effectively manage bank risk to ensure safety and soundness.

Consistent with sound risk-management practices, community banks generally have their overdraft policies reviewed by their board of directors and procedures reviewed by senior management to control the bank's overdraft exposure. Additionally, almost all community banks set limits on the amount of overdrafts that will be paid, with the majority setting variable limits ranging from less than \$400 to more than \$1,000 based on risk.

⁴ The Federal Reserve Board's changes to Regulation E, which went into effect on July 1, 2010, prohibit financial institutions from charging consumers fees for paying overdrafts on automated teller machine (ATM) and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft payment service for those types of transactions. Additionally, the FDIC issued guidance on overdraft payment programs which went into effect on July 1, 2011, advising FDIC-supervised banks to, among other things, provide clear and meaningful disclosures, comply with Regulation E opt-in requirements, honor opt-out requests for check and ACH debit transactions, and monitor excessive overdraft usage and contact customers when they incurred six or more overdrafts in a rolling 12-month period.