

## **Overdraft Explosion:**

**Bank fees for overdrafts increase 35% in two years**

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- Finding 2: Banks and credit unions collected nearly \$24 billion in overdraft fees in 2008.
- Finding 3: Overdraft fee income for banks and credit unions rose 35 percent from 2006 to 2008.

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## OVERVIEW

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**I**t is now standard practice for most banks and credit unions to automatically enroll checking account customers in their most expensive overdraft loan program—one in which the financial institution generally approves transactions when the accountholder does not have enough funds to cover them, in return for a fee of around \$34 per overdraft.

Banks contend that this type of overdraft protection is a service to their customers, helping them to avoid bouncing checks. They further claim that the alternative would be to return the check unpaid, with the customer incurring an NSF fee from the bank and, potentially, a bad check fee from a merchant or a late fee from a landlord or utility company.

However, the reality is far different than the scenario painted by banks. Overdraft fees are most typically triggered not by checks, but by debit card transactions and ATM withdrawals that could easily be denied for no fee.<sup>1</sup> In addition, common banking practices—such as re-ordering transactions from largest to smallest—increase the number of overdraft fees paid by customers rather than helping them avoid charges.<sup>2</sup> Institutions also generally place no meaningful limits on how many fees a customer can incur within a given period.<sup>3</sup> Finally, because banks generally charge a fixed overdraft fee regardless of the size of the transaction covered, the fee bears no relationship to the actual cost to the institution of covering the overdraft. In fact, previous CRL research found that consumers paid about \$2 in fees for every \$1 in credit extended if they overdrew their account using a debit card at a checkout counter.<sup>4</sup>

These practices are especially alarming given that institutions automatically enroll consumers into this type of program, even when lower-cost forms of overdraft protection—such as a formal overdraft line of credit or a link to a savings account—are usually available. Several CRL surveys have found that an overwhelming majority of respondents, including those who have recently overdrawn their account, want a choice about what—if any—form of overdraft program to enroll in and prefer that debit card overdrafts not be covered.<sup>5</sup>

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This report quantifies the number of Americans that have overdrawn their account and are potentially affected by the abusive practices typical of today's overdraft loan programs. It also updates previous CRL estimates of the resulting costs incurred by consumers. To this end, we utilize results from a recent FDIC study to estimate the number of Americans whose accounts become overdrawn in a given year, with a focus on those accountholders with five or more incidents per year. In addition, we also update our 2006 estimate of the total cost consumers pay annually in overdraft fees and evaluate the dramatic increase in fees over a two-year period.

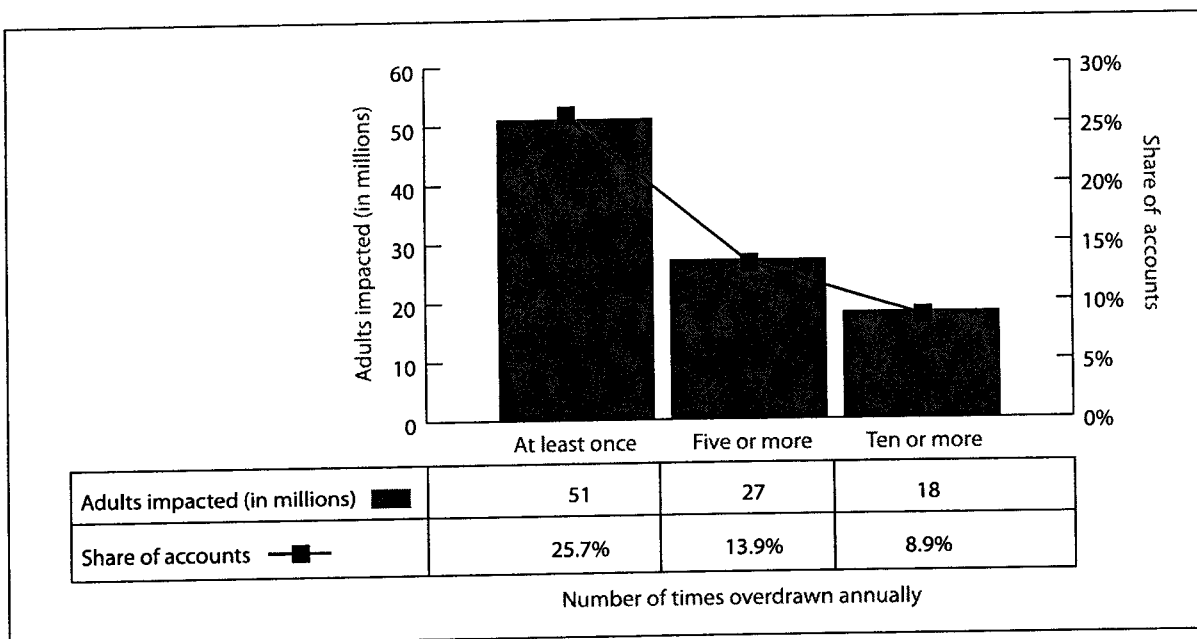
## FINDINGS

### Finding 1: Over 50 million Americans overdraw their checking account at least once over a 12-month period, with 27 million accountholders incurring five or more overdraft or non-sufficient funds (NSF) fees.

A recent survey of 39 FDIC-regulated banks holding 6.5 million accounts found that about one of every four checking accounts became overdrawn at some point over a twelve-month period, and about one out of seven checking accounts was overdrawn five or more times.<sup>6</sup>

If we assume one checking account per adult (excluding those who lack a bank account entirely), an estimated 51 million Americans overdraw their account—and were therefore assessed either an overdraft or NSF fee—over the past 12 months. Perhaps more troubling, over half of those—27 million Americans in all—incur five or more overdraft incidents during the same time period. To put this number into perspective, more Americans overdraw their account at least five times than live in the state of Texas. A majority of accountholders in this category significantly exceeded five overdrafts; nearly two-thirds of these 27 million had ten or more incidents within a one-year period. Table 1 and Figure 1 below detail our calculations.

Figure 1: Share of total checking accounts that become overdrawn during a year and total accountholders affected



**Table 1: Number of adults affected by overdrawn accounts annually**

(A) Total population age 18 and over*	225 million
(B) Population without a bank account**	28 million
(C) Total adults with a bank account (C=A-B)	197 million
(D) Adults impacted by at least one overdraft incident (C*25.7%)	51 million
(E) Adults impacted by at least five overdraft incidents (C*13.9%)	27 million
(F) Adults impacted by ten or more overdraft incidents (C*8.9%)	18 million

\*2008 Current Population Survey, U.S. Census Bureau

\*\*The FDIC's Alliance for Economic Inclusion estimates that as many as 28 million people in the United States are unbanked.

In previous research, CRL found that consumers who repeatedly overdraw their account are more likely to be low-income, single, non-white, and renters.<sup>7</sup> In its analysis of the income and age of account holders with overdrawn accounts, the FDIC found that lower-income groups and young adults age 18-25 were the most likely to incur an overdraft or NSF fee.<sup>8</sup>

**Finding 2: Banks and credit unions collected nearly \$24 billion in overdraft fees in 2008.**

These millions of Americans who overdraw their accounts represent an increasingly significant source of fee income for financial institutions. Banks and credit unions are not required to directly report their total income related to overdraft and NSF fees; however, the FDIC found that nearly three-quarters of its banks' service charge income was the result of overdraft and NSF fees.<sup>9</sup> Using this breakdown, we estimate that banks and credit unions assessed their customers \$34.3 billion in fees when their accounts became overdrawn in 2008. We estimate that 69 percent of this \$34.3 billion, or \$23.7 billion, is comprised of overdraft fees alone.<sup>10</sup>

**Table 2: Total overdraft fees collected by banks and credit unions**

(A) Service charge income (Banks)*		\$39.5 billion
(B) Fee income (Credit Unions)**		\$6.8 billion
(C) Total service charge/fee income, all banks and credit unions (A+B)		\$46.3 billion
(D) Estimated share of (B) and (C) generated by overdraft and NSF fees***	74%	
(E) Estimated total overdraft and NSF fees collected (C*D)		\$34.3 billion
(F) Estimated share of (E) attributable to overdraft fees alone	69%	
(G) Estimated total overdraft fees alone (E*F)		\$23.7 billion

\*Service charge income as reported in FDIC call report data for 2008.

\*\*Fee income (the equivalent of service charge income for credit unions) as reported by the National Credit Union Administration for 2008.

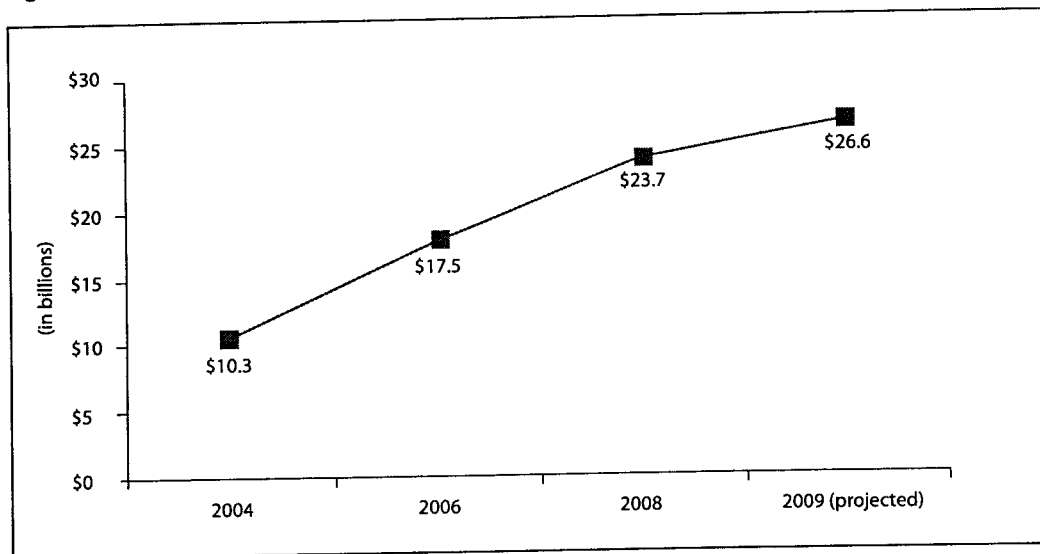
\*\*\*Based on findings from the 2008 FDIC Study of Bank Overdraft Programs.

These fees are likely to be even higher in 2009. One leading analyst of bank and credit union fees projects that \$38.5 billion in overdraft and NSF fees will be collected this year.<sup>11</sup> If our current assumptions hold, overdraft loan fees will comprise nearly \$27 billion of this total amount.<sup>12</sup>

### Finding 3: Overdraft fee income for banks and credit unions rose 35 percent from 2006 to 2008.

Our new estimate that consumers paid \$23.7 billion in overdraft fees in 2008 represents a 35 percent increase since our last estimate in 2006. In absolute terms, overdraft fees increased \$6.2 billion in two years—part of a continuing trend that we have observed since our first estimate in 2004, and which we expect to continue through 2009.

Figure 2: Increase in overdraft fees over time



Rising overdraft fees have several underlying sources. First, many financial institutions have increased the fee per overdraft incident and are more frequently charging additional fees if a customer's account remains overdrawn for several days.<sup>13</sup> In addition, some banks no longer employ caps on the total fees incurred per day, heightening the chances that someone with multiple transactions will pay hundreds of dollars in fees before even knowing their account is overdrawn.<sup>14</sup>

Second, consumers are using debit cards—the most common trigger of overdrafts—both more frequently than in the past and for increasingly small transaction amounts. Today, nearly three-quarters of checking account customers have a debit card, with active card users averaging 17 debit card transactions per month.<sup>15</sup> As a result, debit card usage has exceeded credit card usage since 2005.<sup>16</sup> At the same time, the average debit card transaction size has decreased by about four percent per year, with more than a quarter of all debit card transactions now conducted for purchases of less than \$10.<sup>17</sup> As an analyst from the First Manhattan Consulting Group has noted, “the wide adoption of debit cards had

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—analyst, First Manhattan Consulting Group

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two multiplicative effects: it increased the possibility of a mistake that would take an account negative, and it also increased the number of overdraft events while the customer was unaware he had crossed the line.”<sup>18</sup>

As a result of these trends, service charge income, of which overdraft and NSF fees play an increasingly large part, has steadily increased.

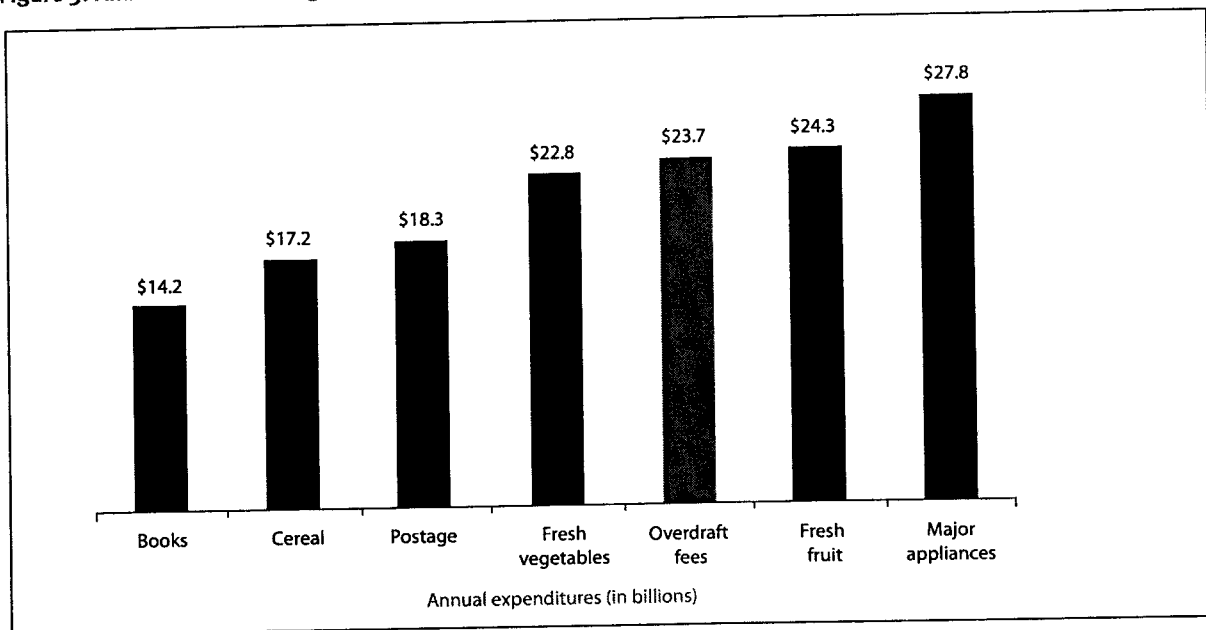
**Table 3: Change in overdraft fees collected, 2006–2008**

	2006	2008
(A) Service charge/fee income	\$42.2 billion	\$46.3 billion
(B) Share of (A) generated by overdraft and NSF fees	60%	74%
(C) Total overdraft and NSF fees collected	\$25.3 billion	\$34.3 billion
(D) Share of (C) attributable to overdraft fees alone	69%	69%
Total attributable to overdraft fees alone	\$17.5 billion	\$23.7 billion

## DISCUSSION

Overdraft fees eat into the already-strained budgets of working families, with Americans now spending far more on overdraft fees annually than they do on common household items such as books, cereal or postage stamps. Americans spend about the same amount on overdraft fees as they do on fresh vegetables every year, and only a little less than they do on fresh fruit.<sup>19</sup>

**Figure 3: Annual fees resulting from overdrafts, as compared to common household expenditures**



Overdraft fees are charged to people who typically are enrolled in an overdraft program without their consent. In most cases—particularly if they are using debit card—survey results show that consumers would rather have their transaction denied than be approved in exchange for a \$34 fee.<sup>20</sup>

**Table 4: Share of respondents who would prefer their transaction be denied at the checkout counter, if account overdrawn, among those with a preference<sup>21</sup>**

	Would prefer to be declined
\$5 transaction	80%
\$20 transaction*	79%
\$40 transaction	77%

\*The average debit card transaction triggering an overdraft fee is \$20.

Overdraft fees triggered by small dollar transactions, most typically occurring when a debit card is used, are especially pernicious because the credit extended to cover the shortfall is often far smaller than the overdraft fee charged. In previous research we found that, even when accounting for overdrafts caused by checks and other triggers, the overall overdraft fees charged exceed the credit extended.<sup>22</sup> For 2008, we estimate that checking account holders receive only \$21.3 billion in credit for the \$23.7 they pay in overdraft loan fees.<sup>23</sup> Put another way, consumers were obligated to repay \$45 billion for \$21.3 billion in extremely short-term credit.<sup>24</sup>

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The Federal Reserve is currently considering whether—and how—to provide better consumer choice about enrollment in bank overdraft programs.<sup>25</sup> As described in our policy recommendations below, however, regulators must go further to curb existing abuses. In addition, Congress is considering larger-scale reforms to overdraft loan programs.<sup>26</sup>

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## ***CONCLUSION & POLICY RECOMMENDATIONS***

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Each year, over 50 million Americans overdraw their checking account, paying nearly \$24 billion in overdraft fees. Twenty-seven million Americans pay five or more overdraft or NSF fees each year. The most common triggers of these fees are small debit card transactions that could easily be denied for no fee.

Financial institutions engage in abusive practices that maximize overdraft fee revenue. They approve debit card transactions that they could deny for no fee; they charge exorbitant fees that bear no relationship to the cost of covering an overdraft; they charge excessive numbers of overdraft fees over the course of a day, month, or year; and they automatically enroll customers in the most expensive overdraft option available.

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