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Mounting U.S. Household Debt and Bank Overdraft Fees

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We have all been shafted by overdraft fees from our bank at some time or another. It's an annoyance and frustration, especially to those of us who already don't have much money as well as a constant puzzle: If one doesn't have $5, how are they going to pay an extra $35? Yet banks continue to do this and rake in money, as can be seen by them having made $35 billion[1] in overdraft fees in 2014. In order to get a better handle on the problem of overdrafts, we need to understand the history of such fees as well as reframe how we look at the situation, changing our perspective to see overdraft fees as a sort of loan rather than a fee.

After World War 2, society as a whole began to change, included how people borrowed money. Credit itself began to change with things such as pawning and open-book credit (in which goods are shipped with the recipient promising to make payments) declined in usage and were replaced with other forms of loans such as payday loans, credit cards, and overdraft protection. However, it wasn't as if everyone had access to overdraft protection, it was generally reserved for those high-income customers who were having short-term problems. Yet, as time wore on more and more people gained access to overdraft protections, with "banks and credit unions [offering] 'courtesy pay' or overdraft features" starting in the mid-1990s "so that consumers could overdraw their checking or debit accounts, for a fee."[2] What was important, though, was that people were accruing these fees on their own, however this would change in the new millennium.

In 2003, it was reported that around 1,000 banks were "encouraging customers with low balances to overdraw their checking accounts, allowing the banks to skirt credit laws and collect billions of dollars in new fees."[3] Banks were now actively encouraging people with little money to spend beyond their limit as to have to pay massive amounts in fees. From the banks' perspective, this made since as USA Today noted in 2005 that overdraft fees "provide a more stable source of income to banks than products tied to fluctuating interest rates."[4]

According to an FDIC 2006 survey, it was reported that "overdraft fees on average represent 6% of total net operating revenues of FDIC-insured banks."[5] It seems that only a small group of banks are making money off of overdraft fees. Data from the company SNL Financial showed that during the first quarter of 2015, the three largest banks (JP Morgan Chase, Bank of America, and Wells Fargo) "collectively generated $1.14 billion from overdraft fees and related service charges"[6] and that those very same banks were also the ones that collected the highest ATM fees of the first quarter. So, not only have banks been actively encouraging people to get overdraft fees, but they were making a killing from it.

There are a number of other problems with overdraft fees, such as their similarity to payday loans and how they act like credit cards, but are worse. A 2005 report from the Consumer Federation of America found that overdraft fees were similar to payday loans in that those without enough money to make ends meet until the next payday were effectively given a cash advance by being able to overdraw their account, however, overdrawing one's account was similar credit card usage.[7] Yet, with credit cards, banks aren't allowed to take funds directly from a person's bank account to pay off a credit card debt, but those who overdraw their account with a debit card "lack this protection. A bank can use the right of setoff when a customer creates an overdraft with a debit card to repay itself immediately when the customer deposits funds into the account."[8] Of course, this doesn't just cover the general costs, but also the overdraft fees that are applied to the account.

The report also found that in many cases, banks allow people to overdraw on purpose when they pay checks that result in overdrawn accounts, "knowingly permit consumers to electronically withdraw funds at the ATM or to make purchases at point of sale," or "pay pre-authorized debits despite the lack of funds in the consumer's account."[9]

In addition to this, banks don't tell consumers of better alternatives, from that same report:

> For example, Citizens Bank's overdraft protection language on its website sells its line of credit or savings account transfer overdraft protection product as offering 'convenience and peace of mind.' On the other hand, Citizens Bank sent an addendum to its deposit disclosure in late 2004 describing the account's 'courtesy' overdraft provisions and informing consumers that overdrawing a check, ATM or debit card transaction would incur a fee of between $25 and $33 each, depending on the number of days the account remains overdrawn. This disclosure did not inform consumers that they could purchase optional savings account overdraft transfer coverage for $3 per month or apply for an overdraft protection line of credit which costs $20 annually, both of which could be more affordable for consumers.[10] (emphasis added)

It seemed that things would change for the better in 2010 as the rules regarding overdraft fees changed. Starting in July, banks were now "required to allow debit card customers to opt-in to overdraft fees rather than automatically enrolling card users in programs that charge $20 to $30 whenever there are insufficient funds to cover purchases,"[11] meaning that if one didn't have the necessary funds to complete a transaction, their debit cards would be declined at the register. Unfortunately, banks found a way around this by engaging in bank fee manipulation. Information came out in August 2010 when a federal judge ordered Wells Fargo "to pay California customers $203 million in restitution for claims that it had manipulated transactions to maximize the overdraft fees it charged."[12]

What occurred was that, rather than dealing with each transaction in the order it was received, Wells Fargo put through the largest to smallest transactions, resulting in people paying increased overdraft fees. The very next year, Bank of America paid out $410 million for the same reasons.[13] But the bank fee manipulation continued, with Forbes reporting on the findings of a 2012 Consumer Financial Protection Bureau (CFPB) report which showed that it was still ongoing.[14]

The situation can get much, much worse though. The Center for Responsible Lending complied a report in July 2013 which found that while the average banks charges an overdraft fee of $35, some banks "also add a 'sustained overdraft fee' once the account has remained overdrawn for several days. At some banks, this is a one-time additional fee in the $35 range; at others, it is a fee in the $6-$8 range charged daily until the account balance is returned to positive" and that while a few banks have put limits on such sustained fees, it "still [allows] for daily fees in the hundreds of dollars."[15] So not only are people's bank fees being manipulated so that they pay more money in overdraft fees, but unless they can come up with the money quickly, the problems worsen.

For all this talk that's been going on, though, we still have yet to discuss exactly who suffers from overdraft fees.

In 2008, the FDIC found that "9 percent of checking account customers bear about 84 percent of overdraft fees" and that evidence pointed to overdraft fees disproportionately impacting low-income and young customers.[16] A CFPB 2014 report reinforced this information as one of the key findings was that "eight percent of customers incur nearly 75 percent of all overdraft fees" and that "10.7 percent of the 18-25 age group [have] more than 10 overdrafts per year."[17]
What effectively occurs with overdraft fees is that the poor subsidize the rich. In an article for The Economist, it was reported that "according to the FDIC low income (people who earn less than $30,000) earners are nearly twice as likely to have paid an overdraft fee"[18] and that it wasn't uncommon for many of these low-income people to rack up fees to the point where they can't pay them all.

When this occurs, banks close the indebted accounts and it is extremely difficult for people to open accounts at other banks. They are effectively shut off from formal banking, thus forcing them to turn to services such as pre-paid cards which "charge for all kinds of things checking account customers are used to getting for free: loading funds on to the card, point-of-sale purchases, talking to a customer service representative, cutting a check"[19] or check cashing which "can incur an average of 3-5% of the check amount in fees, regardless of the nature of the check."[20] The costs of both of these can easily add up to more than what it would cost to have a regular checking account.

Alternatives to overdraft fees are asking one's bank about a linked line of credit[21] or an affordable small-dollar loan.[22] However, the best solution would be to get rid of overdraft fees entirely. By combating overdraft fees, we will be able to free millions of people from the worry of debt and its potential long-term effects.

Notes

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