

Are consumers knowingly consenting to overdraft coverage or are they signing up for a potentially costly product that they don't understand?



Overdraft America: Confusion and Concerns about Bank Practices

Consumers generally have three choices when they have insufficient funds to cover a debit card purchase or ATM withdrawal. They can incur a) an overdraft penalty fee (median cost \$35) in which the bank makes a short-term advance to cover the transaction; b) an overdraft transfer fee (median cost \$10) when the bank transfers funds from a linked account like a savings account, line of credit, or credit card; or, c) if the consumer did not opt in to an overdraft penalty plan and did not apply for an overdraft transfer plan, the transaction will be denied with no fees charged.¹

A survey of consumers, commissioned by Pew's Safe Checking in the Electronic Age Project, found that although almost one-fifth (18 percent) of consumers have incurred an overdraft penalty fee in the last year, their understanding of overdraft rules is weak. More than one-third of respondents surveyed were not aware

their bank offered overdraft coverage until they incurred a penalty, and many also did not know about the tactics banks use that increase costs to consumers, such as reordering deposits and withdrawals. Lower-income and younger consumers are hit the hardest by these penalty fees.

Respondents who have overdrafted are overwhelmingly concerned about bank practices, in particular, the size of the fee, extended overdraft penalty fees (an additional cost applied for failing to pay overdraft penalties on time), and transaction reordering. Most said they preferred that their transaction be declined if they had insufficient funds rather than processed with a subsequent charge. About one-third of respondents closed their checking account due to overdraft fees.

Nine out of 10 Americans have a checking account, making it the most widely used financial services product in the United States.² These accounts provide a secure way for consumers to collect earnings and make payments, and for many, they serve as the entry point to the financial mainstream. It is important to ensure that checking accounts do not lead to financial distress because of hidden, unexpected, and costly fees like overdrafts.

How many Americans overdraft?

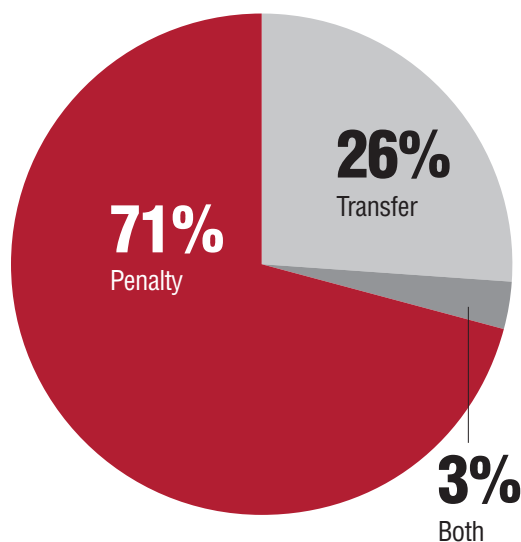
Eighteen percent of consumers had overdrafted within the last year, and almost three-quarters of them had incurred a penalty fee.³ Slightly more than one-quarter paid an overdraft transfer fee.

Almost 1 in 5 people experienced overdrafts on their bank accounts.



Within the past year, have you been charged an overdraft fee by your bank or credit union for using your debit card to make a purchase or withdraw money that caused your account to have a negative balance or become overdrafted?

Nearly three-quarters of those who overdraft incur a penalty fee.



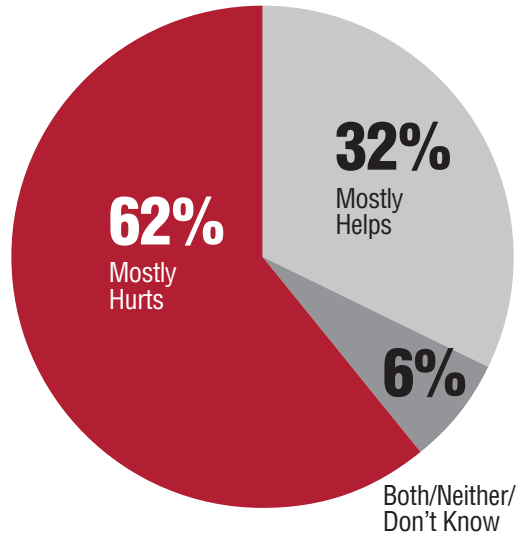
Was the overdraft covered by a transfer from another account you have with the bank or credit union, or did your checking account balance become negative?

Are consumers satisfied with overdraft policies and practices?

Most respondents have strong views about these bank practices. Forty percent think the terms and conditions of their financial institution's overdraft policies are somewhat or very confusing, and more than 60 percent of consumers who incurred overdraft fees believe this service hurts more than helps.

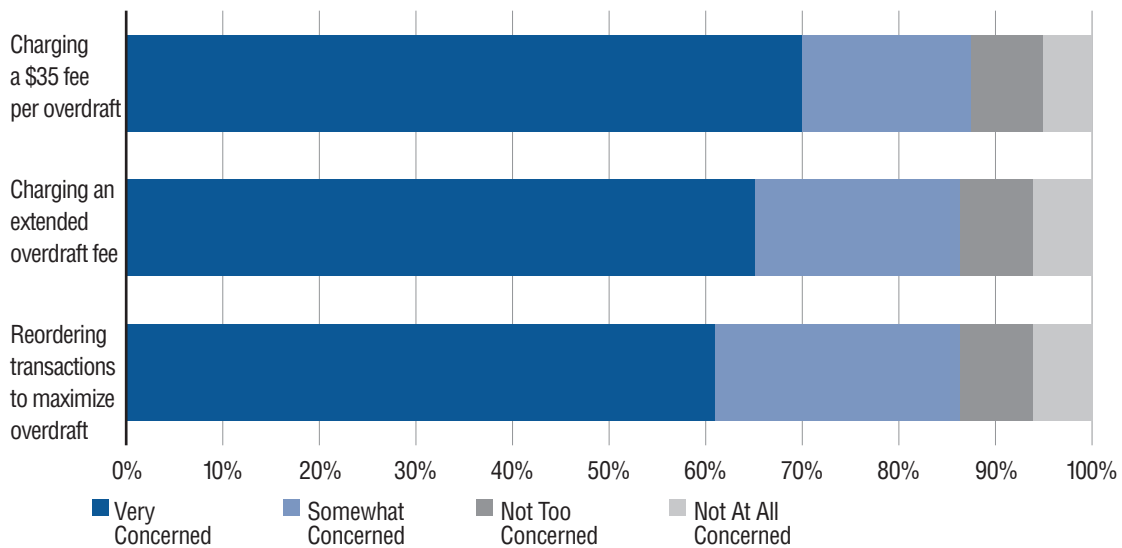
More than 85 percent of consumers who had overdrafted were concerned about the size of the \$35 penalty fee, charging an extended overdraft penalty fee, and reordering transactions to maximize fees.

More than half of those who overdrafted believe that this service mostly hurts consumers.



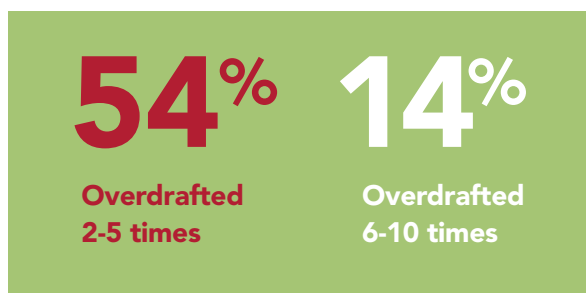
Overall do you think that overdraft coverage for a fee mostly helps consumers like you or mostly hurts consumers like you?

Consumers have strong concerns about bank overdraft practices.⁴



How often do overdrafts occur?

Most respondents overdrafted more than once. In fact, within the past year, over half of respondents (54 percent) overdrafted two to five times, and 14 percent overdrafted six to 10 times.



Are consumers informed about overdraft services?

Most people were surprised when they incurred a fee because they were not aware that their bank offered overdraft coverage or because they only discovered the cost of a penalty after they had overdrawn their account. Almost all respondents (90 percent) said they overdrew their checking account by mistake; 7 percent said they did so intentionally, and 3 percent responded that in the past they both accidentally and deliberately had their checking account go into a negative balance.

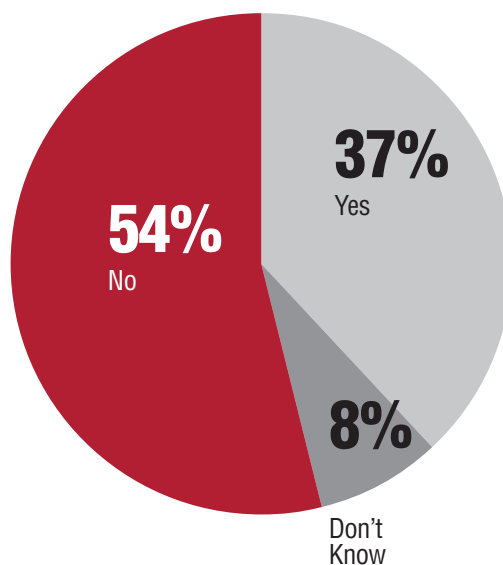
As of August 15, 2010, Federal Reserve rules require that financial institutions obtain affirmative consent (“opt in”) from consumers before enrolling them in an overdraft penalty plan that covers debit card point-of-sale and ATM transactions.⁵ Despite this requirement, many accountholders remain unsure of whether they agreed to and presently have overdraft coverage.

Ninety percent of overdrafters said they overdrew their checking account by mistake.



When you overdrew the money in your checking account, causing a negative balance, did you do it intentionally or by mistake?

More than half of overdrafters did not believe they opted in to coverage.



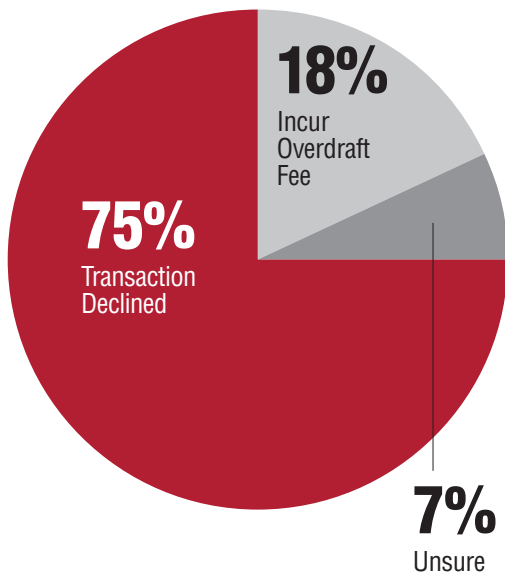
As far as you know, did you choose to sign up for overdraft coverage, where you are charged a fee for each overdraft, or not?

Do consumers want transactions covered by overdraft?

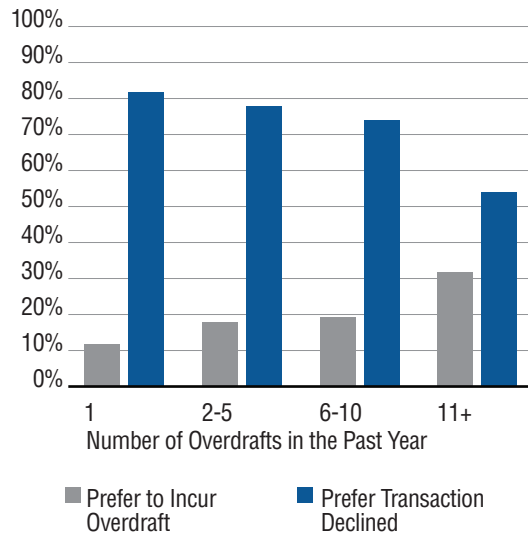
Respondents overwhelmingly (75 percent) stated they would prefer that a transaction be declined if there is not enough money in their account rather than have it processed and subsequently be charged a \$35 penalty fee. A majority preferred that the transaction be declined rather than be charged a fee no matter how many overdrafts they had incurred in the last year.

Of those consumers who incurred overdraft fees, three-fourths (77 percent) paid off their overdraft penalty on time, but one-quarter (23 percent) did not and consequently had to pay an extended overdraft penalty fee.

A large majority of overdrafters prefer having a transaction declined.⁶



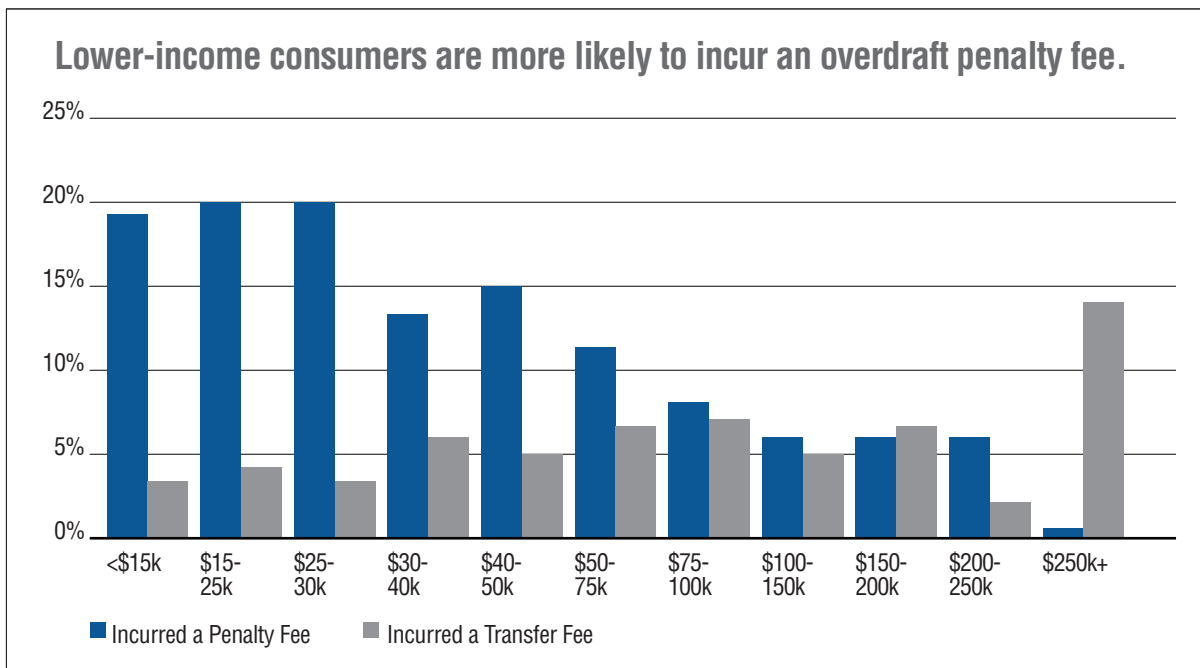
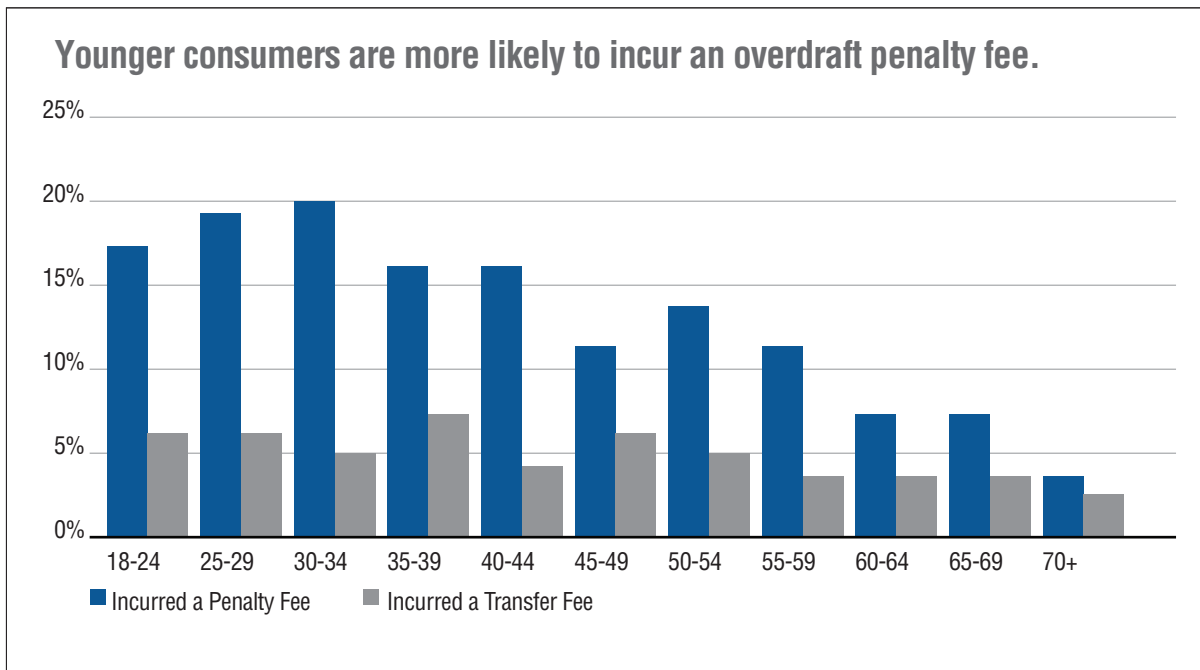
Customer preference between incurring an overdraft fee or having a transaction declined by overdraft history.



Who overdrafts?

The survey found that age and income matter when it comes to incurring these fees. Consumers under the age of 44 are nearly twice as likely to incur an overdraft penalty fee than those 44 and older (17 percent vs. 9 percent).

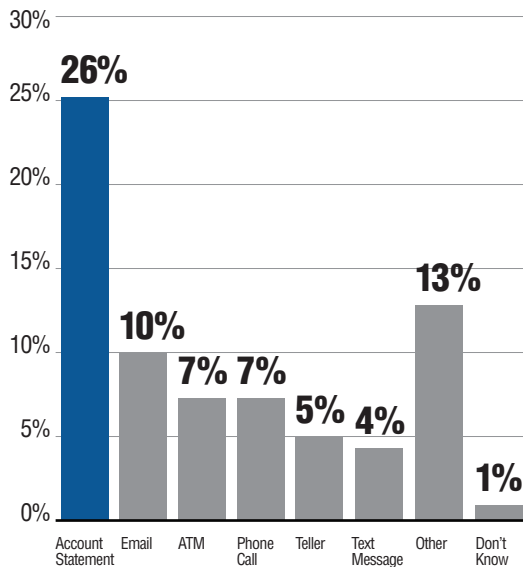
Consumers making less than \$30,000 a year are nearly twice as likely to incur an overdraft penalty fee than those making more than \$30,000 (20 percent vs. 10 percent).



How are consumers informed?

When asked how they found out about their overdraft, respondents were most often informed through an account statement. It could be days or weeks before a consumer receives this notification, potentially leading to compounded overdraft fees.

Account statements were the most common method for overdraft notification.

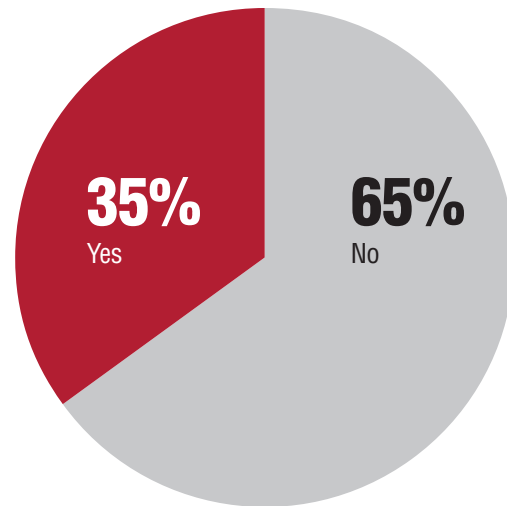


How did you find out that your checking account had a negative balance and that your bank or credit union was covering the overdraft and charging a fee?

How do consumers react to overdraft fees?

Consumer dissatisfaction with overdraft procedures and fees is driving many to leave their financial institution. In fact, about one-third of respondents reported that they had closed their checking account due to overdraft fees.

About one-third of overdrafters closed their bank account due to overdraft fees.



Have you ever closed a checking account because of overdraft fees, or have you never done that?

Policy Recommendations

Pew calls on the Consumer Financial Protection Bureau to require all financial institutions to:

- Provide accountholders with clear, comprehensive, and uniform pricing information for all available overdraft options;
- Make overdraft penalty fees reasonable and proportional to the bank's costs in covering the overdraft; and
- Stop the process of reordering transactions to maximize fees, and post deposits and withdrawals in a fully disclosed, objective, and neutral manner.

Survey Overview

Pew's survey explored accountholder knowledge, understanding, and attitudes about overdraft penalty fees.

Researchers asked whether consumers had chosen to be covered by their financial institution's overdraft service, the means by which they received notification of their negative bank account balance, and the impact overdraft fees had on their behavior.⁷ Seventy-six percent of respondents presently have a primary checking account with a bank, 13 percent with a credit union, 2 percent with both, and 9 percent do not have a checking account. Over half, 56 percent, also utilize a savings account at the same financial institution where they have their checking account, and 45 percent do not.⁸

METHODOLOGY

To assess the impact of overdraft fees, Pew commissioned Social Sciences Research Services (SSRS) to conduct a survey of consumers who overdrafted in the past year. Interviews were conducted from March 7-April 15, 2012 among a nationally representative sample of 6,043 respondents age 18 and older. Of those, a total of 606 respondents qualified to complete the interview because they had been charged an overdraft penalty fee by their financial institution in the past year for using their debit card to make a purchase or withdraw money that caused their account to have a negative balance. The margin of error for total qualified respondents is +/-3.98 percent at the 95 percent confidence level.

Endnotes

1 For discussion of median overdraft penalty and transfer fees, see the Pew Health Group, “Hidden Risks, the Case for Safe and Transparent Checking Accounts,” April 2011.

2 FDIC, “FDIC National Survey of Unbanked and Underbanked Households.” Federal Deposit Insurance Corporation, Dec. 2009, available at: http://www.fdic.gov/householdsurvey/full_report.pdf. FILES: 2009 American Community Survey 1-Year Estimates (United States), ACS Demographics and Housing United States prepared by the U.S. Census Bureau, 2009. http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_09_1YR_DP5&prodType=table. The FDIC estimates that in 2009 there were 17,000,000 adult Americans who were unbanked (those who lacked a deposit account at a bank or credit union). The U.S. Census Bureau’s American Community Survey estimated that in 2009 there were 232,509,573 adult Americans total. This means that 7.31% of adult Americans were unbanked (i.e. had no checking account). Conversely then, as of 2009, 92.69% of adult Americans had a checking account, which is approximately nine out of 10 adult Americans.

3 Pew focused its survey on those accountholders who incurred an overdraft penalty fee and did not further survey the consumers who used overdraft transfers to cover their negative bank account balance.

4 Respondents were asked the following:
For each of these three bank overdraft practices:

- Reordering your withdrawals in a way that makes you more likely to overdraft your account;
- Charging a fee of around \$35 for each overdraft; and
- Charging an extended overdraft fee of around \$25 for not paying off the overdraft penalty on time, usually within 7 days,

Does that make you very concerned, somewhat concerned, not too concerned, or not at all concerned?

5 12 C.F.R. § 1005.17(b) (effective February 7, 2013). This regulation is currently published under 12 C.F.R. § 205.17(b). The Electronic Fund Transfer Act rulemaking authority was transferred from the Federal Reserve to the Consumer Financial Protection Bureau (CFPB) by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The CFPB wrote a regulation that addressed some technical aspects of the rules but did not change the substance of the regulation. Electronic Fund Transfers, 76 Fed. Reg. 80120 (CFPB Dec. 27, 2011) (interim final rule).

6 Respondents were asked the following:
Pretend for a moment that you are at a store about to use your debit card to make a purchase and that you are unaware there is not enough money in your checking account to cover that purchase. Would you rather:

- 1) Have your purchase denied, or
- 2) Have your purchase go through for an overdraft fee of \$35 or so?

7 On behalf of Pew, Social Science Research Solutions as part of a larger omnibus survey asked consumers about overdraft penalty fees from March 7, 2012 to April 15, 2012.

8 In some cases percentages may add up to more than 100 percent due to rounding.

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The Pew Safe Checking in the Electronic Age Project is dedicated to data driven research on deposit accounts. The project raises awareness, builds partnerships with industry, and advocates for policies that reduce risks and allow Americans to responsibly manage their checking accounts.

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