

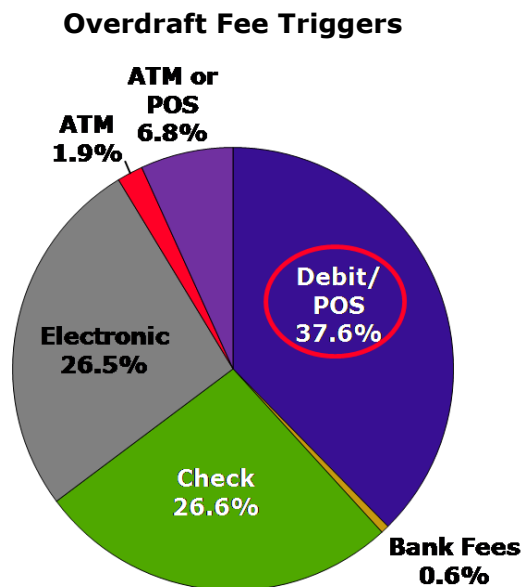
## Overdraft Services Fees: The \$45 Cappuccino

### *Potential Impacts of Pending Policy Changes*

A woman walks into Starbucks and orders a double tall cappuccino for \$3.61. She gives the cashier her debit card, her transaction is approved, and she leaves the store. Unknown to her, the purchase caused or increased an overdrawn condition on her account—even though the transaction was approved. Later that week, she receives her account statement in the mail and has been charged not only for the coffee, but also an overdraft service fee of \$34 and a minimum balance fee of \$7. That \$3.61 cappuccino ended up costing her \$44.61.

Today, many customers are unaware of the fees charged when they overdraw their account, especially if they do not keep tight reigns on their balances. While overdraft services fees vary, most financial institutions charge overdraft services fees on a per-item basis up to a specified daily maximum. Financial institutions may charge an initial teaser rate for the first instance of an overdraft followed by a sharp increase in the fee for subsequent occurrences. In addition, some also charge minimum balance or negative balance fees.

In 2007, consumers paid over \$17.5 billion in overdraft services fees.<sup>1</sup> Debit card POS transactions are the most common payment method resulting in an overdraft.



Source: "Debit Card Danger", Center for Responsible Lending, January 25, 2007

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<sup>1</sup> "Shedded Security: Overdraft Practices Drain Fees From Older Americans", Center for Responsible Lending, June 18, 2008

Over the past several years, financial institutions have depended on overdraft services fees as a consistent stream of fee income. As the economy weakens, fee income assists financial institutions with their bottom line. However, given the dramatic rise in overdraft services fees in recent years, the issue has generated increased attention by policy makers, consumer-advocacy groups, and the media.

Historically, if a consumer made a transaction that resulted in an overdraft of their account, the consumer's depository institution used its discretion on an ad hoc basis to determine whether to pay the overdraft, typically imposing a fee. The Federal Reserve Board recognized this ad hoc practice when it initially adopted Regulation Z in 1969 to implement the Truth in Lending Act. The regulation provided that these transactions are generally not covered under Regulation Z where there is no written agreement between the consumer and institution to pay an overdraft transaction and impose a fee. The treatment of overdrafts was designed to facilitate depository institutions' ability to accommodate consumer spending.<sup>2</sup>

While a customer is ultimately responsible for managing their account balance, consumer advocates believe that customers are not adequately informed about overdraft services fees and programs.

Recently, selected financial institutions have stated that overdraft protection programs help consumers avoid embarrassment, inconvenience, and other adverse consequences for a denied transaction or bounced check. They argue that overdraft protection is not only something consumers want, but something they need.

Consumers, on the other hand, are becoming increasingly enraged with the overdraft services fees they are charged. Customers may be automatically enrolled in overdraft services programs without sufficient education. These programs use bank funding to pay a customer's checks, debit card purchases, ATM withdrawals, and other electronic transactions when sufficient funding does not exist in the customer's account. Customers often do not realize they may be overdrawing their account and be subject to the assessment of fees. The issue is as much about informing customers about fees as it is about the fees themselves.

As overdraft services fees continue gaining momentum and making headlines, pending policy changes may require financial institutions to make significant changes that could be time consuming and costly.

### ***Pending Policy Changes***

On July 27, 2005, Representative Carolyn Maloney (D-NY) introduced H.R. 946, the Consumer Overdraft Protection Fair Practices Act. The act extends the protections provided in the Truth in Lending Act and is intended to:

- Ensure that consumers opt-in to overdraft courtesy pay protection, rather than being forced into them without notification;

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<sup>2</sup> "Regulation DD; Docket No. R-1315, Truth In Savings", Federal Register, Vol. 73, No. 97; May 18, 2008

- Require that consumers are alerted when they are about to overdraw from their account at ATMs and debit card POS terminals; and
- Require that banks provide full, written disclosure of their overdraft policies to customers

On February 8, 2007 Representative Maloney submitted another version with the same title, H.R. 946, the Consumer Overdraft Protection Fair Practices Act. The bill is co-sponsored by Barney Frank (D-MA), Chairman of the Financial Services Committee.

Representative Maloney feels banks should charge for their services, however, she believes, "in being up front and giving customers the information they deserve".<sup>3</sup> She feels customers should be notified of their options as they relate to overdraft fees and be given the choice of whether they will pay the fee or not.

In addition, the Federal Reserve Board has proposed amendments to Regulation AA (Unfair or Deceptive Acts or Practices) and Regulation DD, which implements the Truth in Savings Act.

The proposed amendments to Regulation AA related to overdraft services require two changes:

- 1) The proposal would prohibit banks from imposing a fee for paying an overdraft unless the bank has provided the consumer with an opportunity and a reasonable amount of time to opt out and the consumer has not elected to opt out.
- 2) The proposal would prohibit banks from imposing a fee when the account is overdrawn solely because a hold was placed on funds in the consumer's deposit account.

Proposed amendments to Regulation DD are focused on written disclosures to customers and include the following:

- The proposal would require financial institutions to disclose the aggregate dollar amounts charged for overdraft and return item fees on periodic statements.
- If a financial institution provides account balance information through an automated system, they would need to disclose the amount of the consumer's funds available for immediate use or withdrawal. The amount disclosed may not include additional amounts that the institution may provide to cover an item when there are insufficient funds in the customer's account.

### ***Potential Impacts of Legislation***

If the pending policy changes are passed, financial institutions will be faced with significant challenges to comply with the proposed changes, all of which would require significant investment from a time, resource, and budget perspective.

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<sup>3</sup> "New Report Detailing Overdraft Fees Underscores Need for Disclosure Legislation", January 25, 2007

## **1. Debit Card Processing at the Point of Sale**

Today, most debit card transactions are approved at the point of sale regardless of whether the customer has sufficient funds. If policy changes are implemented, changes will likely need to be made to the way these types of transactions are processed. If a customer does not have adequate funds to cover the purchase, policy changes may require debit cards to be declined at the time of the purchase.

## **2. Increased written disclosures**

Financial institutions may be required to update their processes for disclosing written information about overdraft protection programs to customers. They may be required to include account disclosures at account opening as well as with statements.

## **3. Changes to check and debit card clearing processes**

Financial institutions have the ability to post items based on their own criteria. They can clear checks in ascending or descending check number order, dollar amount order, or debits before credits order based on their business practices. Under the current version of H.R. 946, financial institutions would be prohibited from manipulating the order in which checks and debit card transactions are cleared.

## **4. ATMs alerts for overdrawn accounts**

While ATM usage is not a primary source of transactions resulting in an overdraft, changes may be required to the user-interface to inform customers about charges. Under the proposed policy changes, ATMs will inform customers when an overdraft fee applies (Wells Fargo is one bank who already does this). When a user is at an ATM and they are about to overdraw their account, a pop-up message will appear informing them of additional fees associated with the transaction and give them the option to continue or terminate the transaction. The message will be similar to the fee notices that ATMs provide when using an out-of-network ATM. If these alerts are added, customers will be sufficiently informed about potential fees associated with their actions.

### ***Keeping Perspective***

Financial institutions have offered some sort of overdraft services to customers for over 40 years and they have the right to charge customers for services they provide. At the same time, customers receiving the services need to obtain sufficient information in order to make informed decisions or they will raise red flags.

While policy changes regarding overdraft services charges may or may not be implemented, the attention to this issue is unlikely to wane. The \$45 cappuccino will continue making headlines and fueling efforts against overdraft fees. Financial institutions need to be prepared for continuous efforts by advocacy groups to change their overdraft services programs, especially as the economy continues to weaken and consumers pay a little more attention to their bank accounts.

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