FDIC **Study of Bank Overdraft Programs**

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Executive Summary

In 2006, the Federal Deposit Insurance Corporation (FDIC) initiated a two-part study to gather empirical data on the types, characteristics, and use of overdraft programs operated by FDIC-supervised banks. The study was undertaken in response to the recent rapid growth in the use of automated overdraft programs, defined as programs in which the bank honors a customer's overdraft obligations using standardized procedures to determine whether the nonsufficient fund (NSF) transaction qualifies for overdraft coverage. Little empirical data have been available on these programs, their features, their managing practices, the fees imposed, and consumer usage patterns.

Data and information for the FDIC's study were gathered through a survey of a sample of institutions representing 1,171 FDIC-supervised banks, and a separate data request of customer account and transaction-level data from a smaller set of 39 institutions.[1] The two-part study was designed to obtain the following types of information related to overdraft programs: characteristics, features, and fees of overdraft programs; transaction-processing policies; marketing and disclosure practices; internal controls and monitoring practices; the role of vendors and third parties in overdraft program implementation; and NSF-related fee income and growth. The customer account and transaction-level data collection was designed to gather information on the provision of overdraft services on customer accounts, the occurrence of NSF activity covered under automated overdraft programs, and the characteristics of customer accounts that tend to incur the highest volume of overdraft fees. It was also designed to identify specific aspects of overdraft program use that may be appropriate for more rigorous quantitative inquiry.

The FDIC believes that objective information on these programs will help policymakers make better-informed policy decisions and will help the public better understand the features and costs related to automated overdraft programs. The study results also will help the banking industry develop more effective overdraft programs to better serve consumers.

This report provides key study findings pertaining to the growing provision of automated overdraft programs, enrollment practices, credit limits and fees, marketing and disclosure practices, transaction processing, and NSF-related revenues. Results from the account and transaction-level data collection are also included in this report based on the data received from the 39 banks. These latter results suggest areas that may benefit from further study.

Key findings from the survey of 462 FDIC-supervised banks are as follows:

1. The majority (86.0 percent) of banks operated at least one formal overdraft program—either automated, linked accounts, or lines of credit (LOC).[2] Large banks (defined as those with at least $1 billion in assets) tended to offer a fuller menu of overdraft programs. The share of all banks offering automated overdraft programs was 40.5 percent, but large banks were also significantly more likely to operate automated overdraft programs (76.9 percent), suggesting that a significant share of customer transaction accounts operated under automated overdraft programs.

[1] The study population was 1,171 FDIC-supervised institutions scheduled for on-site examinations from May through December 2007 and FDIC-supervised institutions with at least $5 billion in assets. The survey was administered to a stratified, random sample of 462 institutions from the study population. The 39 banks from which transaction data were received were a nonrandom subset of the 462 banks surveyed; therefore, the results are not generalizable beyond the 39-bank sample. See Section II, Methodology, for a more detailed discussion of the study methodology.

[2] **Automated overdraft programs** are usually a computerized program by which the bank honors a customer's overdraft obligations using standardized procedures or a matrix to determine whether the NSF occurrence qualifies for the overdraft coverage. **Linked transfer accounts** (linked-accounts) are defined as a contractual agreement between a bank and a customer, linking the customer's transaction account with other accounts within the bank, including savings and credit card accounts. **Overdraft lines of credit** (LOCs) are contractual agreements between a bank and a customer stating that the bank will lend up to a specified amount over a defined period to cover overdraft items.

2. The number of FDIC-supervised institutions providing automated programs has grown rapidly over the past several years. Most banks (69.4 percent) initiated their automated overdraft programs after 2001. Large banks were more likely (55.4 percent) to have had an automated overdraft program in place in 2001.

3. Most banks (75.1 percent) automatically enrolled customers in automated overdraft programs, although customers were usually permitted to affirmatively opt out of the program. Survey comments indicated that in some cases, customers were not given the choice to opt in or out of the automated program.

4. By contrast, almost all banks (94.7 percent) treated linked-account programs as opt-in programs, requiring that customers affirmatively request to have accounts linked. In addition, customers have to apply and qualify for an overdraft LOC program, so these programs typically operate on an opt-in basis.

5. Most banks (73.0 percent) established credit limits for automated overdraft customers in written policies, consistent with the bank's lending program. Automated overdraft credit limits stipulated in these policies ranged from $85 to $10,000, and the median credit limit was $500.

6. Automated overdraft usage fees assessed by banks ranged from $10 to $38, and the median fee assessed was $27. About one-fourth of the surveyed banks (24.6 percent) also assessed additional fees on accounts that remained in negative balance status in the form of flat fees or interest charged on a percentage basis.

7. Fees assessed for linked-account and overdraft LOC programs were typically lower than for automated overdraft programs. Almost half of the banks with linked-account programs (48.9 percent) reported charging no explicit fees for the service. The most common fee associated with linked-account programs was a transfer fee; where charged, the median transfer fee was $5. The primary cost associated with overdraft LOC programs was the interest charged on funds advanced, usually accruing at an annual percentage rate (APR) of around 18 percent.

8. The majority (81.0 percent) of banks operating automated programs allowed overdrafts to take place at automated teller machines (ATMs) and point-of-sale (POS)/debit transactions. However, most banks whose automated overdraft programs covered ATM and POS/debit transactions informed customers of an NSF only after the transaction had been completed (88.8 percent of banks for POS/debit transactions and 70.7 percent of banks for ATM transactions). A minority of banks (7.9 percent for POS/debit and 23.5 percent for ATMs) did inform consumers that funds were insufficient before transactions were completed at these locations, offering the customers an opportunity to cancel the NSF transaction and avoid a fee.

9. A significant share of banks (24.7 percent of all surveyed banks and 53.7 percent of large banks) batched processed overdraft transactions by size, from largest to smallest, which can increase the number of overdrafts.

10. More than half of banks with automated overdraft programs (54.2 percent) reported that they relied on a third-party vendor to implement or manage the program. Small banks (those with less than $250 million in assets) were more likely to rely on vendors and third parties for automated overdraft program implementation and management. Most banks using vendors to manage their automated overdraft programs (70.6 percent) also reported that they paid third-party vendors a percentage of the fees generated by the program, typically 10 to 20 percent of additional fees generated.

11. The banks earned an estimated $1.97 billion in NSF-related fees in 2006, representing 74 percent of the $2.66 billion in service charges on deposit accounts reported by these banks in their Reports of Conditions and Income (Call Reports).[3] Total NSF-related fee income accounted for roughly

[3] Banks were asked to report annual NSF-related fee income associated with the processing of all NSF transactions. Fee income data cited are estimates for study population banks only and do not represent estimates for other segments of the banking industry.

6 percent of the total net operating revenues earned by the banks. Banks operating automated overdraft programs earned $1.77 billion in NSF fees in 2006, accounting for 90 percent of total NSF-related fee income earned by the entire study population.

12. Banks that operated automated overdraft programs had higher NSF-related fee income (measured as a share of operating revenues) compared with other banks. In addition, banks whose automated program covered ATM and/or POS/debit transactions and banks that batch processed transactions largest-to-smallest reported higher fee income than those that did not have these features.
13. Consumer complaints about automated overdraft programs were received by 12.5 percent of banks that operated these programs, compared with consumer complaints from less than 1.0 percent of banks offering linked-account programs and 1.5 percent of banks offering overdraft LOC programs. Complaints about automated overdraft programs were more common for large institutions than for small institutions (21.7 percent versus 10.6 percent).
14. Automated overdraft programs operated by banks were characterized as either "promoted" or "nonpromoted."[4] The survey results revealed important differences in bank marketing and disclosure practices between automated and nonautomated overdraft programs. However, in most cases survey disclosure results regarding automated overdraft programs applied only to promoted programs. Although banks that operated nonpromoted automated overdraft programs accounted for a minority (8.5 percent) of banks, these banks were typically large and accounted for more than half (51.7 percent) of the transaction account dollars held by all banks.

Results from the analysis of micro-level data from 39 banks with aggregate assets totaling $332 billion and 6.5 million customer accounts are as follows:[5]

1. Micro-data banks reported 22.6 million NSF transactions incurred by consumer accounts during the 12-month period of analysis. Almost all (22.5 million) of the NSF transactions analyzed were reported by banks that operated automated overdraft programs.
2. Although almost 75 percent of consumer accounts had no NSF transactions during the 12-month period examined, almost 12 percent of consumer accounts had 1 to 4 NSF transactions, 5.0 percent had 5 to 9 NSF transactions, 4.0 percent had 10 to 19 NSF transactions, and 4.9 percent had 20 or more NSF transactions. Almost 9 percent of consumer accounts of banks reporting data had at least 10 NSF transactions during the 12-month period of analysis.[6]
3. Customers with 5 or more NSF transactions accrued 93.4 percent of the total NSF fees reported for the 12-month period. Customers with 10 or more NSF transactions accrued 84 percent of the reported fees. Customer accounts with 20 or more NSF transactions accrued over 68 percent of the reported fees.
4. Customer accounts with 1 to 4 NSF transactions were charged $64 per year in NSF fees on average. Customer accounts with 5 to 9 NSF transactions were charged $215 per year in NFS fees on average. Customer accounts with 10 to 19 NSF transactions were charged $451 per year in NFS fees on average. Customer accounts with 20 or more NSF transactions were charged $1,610 per year in NSF fees on average.

[4] "Promoted" automated overdraft programs are those in which the customers are informed of the existence of the overdraft program. "Nonpromoted" automated overdraft programs are those in which customers are not informed of the existence of the overdraft program.

[5] Bank assets reported as of December 2006.

[6] For this study, NSF transaction data include NSFs covered by an automated overdraft program and returned or unpaid, as well as NSFs processed on an ad hoc basis, although nearly all NSFs were reported by banks that operated automated overdraft programs. Data on NSF transactions processed under linked-accounts or LOC programs were not collected.

5. Accounts held by customers in low-income areas (in some areas, median annual income of less than $30,000) were more likely than accounts in higher-income areas to incur overdraft charges.[7] More than 38 percent of low-income accounts had at least one NSF transaction, compared with 22 percent of upper-income accounts.

6. Recurrent overdrafts were also more likely the lower the income group. Among low-income customers, 16.7 percent of accounts had 1 to 4 NSF transactions, and 7.5 percent had 20 or more NSF transactions. By comparison, 13.9 percent of accounts held by moderate-income consumers had 1 to 4 NSF transactions, and 6.4 percent had 20 or more NSF transactions. Consumers in upper-income areas had 1 to 4 NSF transactions in 10.5 percent of accounts and 20 or more NSF transactions in 3.8 percent of accounts.

7. Almost half (48.8 percent) of all reported NSF transactions took place at POS/debit (41.0 percent) and ATM (7.8 percent) terminals. Checks accounted for 30.2 percent of the reported NSF transactions.

8. The median dollar amount of all 22.5 million transactions processed by the micro-data banks with automated overdraft programs was $36. POS/debit NSF transactions were not only the most frequent, but also the smallest, with a median dollar value of $20. The median transaction size of an ATM withdrawal and a check that resulted in an NSF transaction were $60 and $66, respectively.

9. Assuming a $27 overdraft fee (the survey median), a customer repaying a $20 POS/debit overdraft in two weeks would incur an APR of 3,520 percent; a customer repaying a $60 ATM overdraft in two weeks would incur an APR of 1,173 percent; and a customer repaying a $66 check overdraft in two weeks would incur an APR of 1,067 percent. More rapid repayment of the overdraft amount results in higher APRs, and slower repayment results in lower APRs.[8]

10. Accounts held by young adults (ages 18 to 25) were the most likely among all age groups to have automated overdraft NSF activity. Among young adult accounts, 46.4 percent incurred NSF activity, compared with 12.2 percent of accounts held by seniors (over age 62) and 31.9 percent of accounts held by other adults. Nearly 15 percent of accounts held by young adults recorded more than ten NSF transactions during the year, compared with 12.1 percent of adult accounts and 3.0 percent of senior accounts. Most NSF transactions made by young adult accounts (61.7 percent) originated at a POS/debit terminal.

[7] Actual median income limits for each income level designation vary by metropolitan statistical area. The income limit provided is a benchmark calculated based on the 2006 median family income for the United States. (Source: U.S. Census Bureau, 2006 *American Community Survey*.)

[8] These examples assume that the credit extended as a result of the overdraft occurrence equaled the total transaction, that the consumer repaid the credit extended in two weeks, and that no additional fees are imposed on the consumer as a result of the NSF. The APRs were calculated as follows: ((Fee Charged/Amount Financed)*365)/Term (14 days).