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Overdraft fees big business for banks, bad for you

By Brent Hunsberger, The Oregonian

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Did you know that if you overdraw your checking account at most big banks you get an immediate loan covering the charge until you deposit more money?

Great deal, right?

Now what if I told you the bank does this for a fee that, on many debit card charges, is akin to a loan of at least 1,000 percent interest?

It will do this without your permission or stopping payment instead. It might even rearrange your charges so it pays the largest first, potentially triggering even more overdrafts.

This "service" is standard practice among big banks, one that they say customers -- particularly small businesses -- overwhelmingly want. Certainly, if you're prone to bouncing a \$1,000 rent check, it's a nice safeguard.

But many of us use debit cards these days, frequently on \$3 lattes. As such, the overdraft practice is coming under fire on many fronts. For good reason.

The average \$27 bank overdraft fee on a \$20 debit is like paying 3,250 percent interest on a two-week, \$20 loan.

That's not my calculation. That comes from a 2008 Federal Deposit Insurance Corp. **study** on the fees.

"Overdraft loans are payday lending by banks," says Jean Ann Fox, director of financial services at the Consumer Federation of America.

Sure, some overdrafters deserve penalties. If you chronically flirt with the bottom line in your account, you're doing yourself in.

But my hunch is that more people are going to get hit with these fees, especially those living from unemployment check to unemployment check or adjusting to pay cuts. Lenders have cut access to credit cards and other short-term loans. That means we're relying more on debit cards, exposing us to these charges.

And customers who overdraft are likely to be poor and least able to afford the charges, the FDIC found.

"What the banks have forgotten is that it's not their money. It's my money," said Debra Mayer, an unemployed teacher from Beaverton. She got hit with \$105 in overdraft charges Aug. 3 on three transactions totaling \$60. Bank of America Corp. removed the charges after she complained.

Unfortunately, financial institutions increasingly rely on these charges. Overdraft fee revenue at 16,000 U.S. financial institutions will top \$38 billion this year, said Mike Moebs, a financial industry consultant and founder of Moebs Services Inc.

Banks alone got about 6 percent of their net operating revenue from earnings on these fees, the FDIC said. And, as loan and credit card losses mounted last year,

Protect yourself against overdrafts

Few of us overdraw our checking accounts, but it's more of a struggle to avoid among those earning low pay, drawing unemployment or on a fixed income.

Until Congress or the courts change how overdraft fees work, here are some tips for avoiding them:

Opt out of overdraft programs. Most banks allow for this. (Bank of America, notably, does not, according to a spokeswoman.) But you must ask.

With some banks, opting out means a debit charge or ATM withdrawal would be merely rejected if your account is depleted, said

Moebs estimates, net overdraft income exceeded overall net income at 7,000 institutions last year.

It helps banks' bottom line (but not consumers') that they often shift the order in which they process electronic transactions, working from the largest amount to the smallest, instead of the order in which they came in.

Banks say customers want this because larger transactions -- mortgage payments, for instance -- are more important to cover than smaller ones. But consumer advocates note that the reordering causes smaller transactions to draw fees they otherwise wouldn't.

According to the FDIC, one-quarter of all banks -- but half of all large banks -- process overdrafts in batches from largest to smallest. Those that did reported proportionately higher fee income.

Many banks do this entirely at their whim, as they warn in the fine print of account agreements.

It's the target of April Speers' **class-action lawsuit** against U.S. Bancorp, the largest in Oregon, filed in April in U.S. District Court in Portland .

Speers alleges that U.S. Bank reordered 22 charges she made on her debit card from Jan. 8 to Jan. 12. As a result, the bank assessed \$225 in overdraft fees on her six smallest transactions, which totaled \$49.60.

Had the bank processed the transactions as they came in, Speers would have sustained one \$37.50 overdraft fee on a single \$87.80 Internet transaction, her complaint states.

Speers and her attorneys, none of whom returned messages seeking comment, allege that the bank's practices violate Oregon consumer protection laws. U.S. Bank, responding in court, denied any violations. An arbitration clause in Speers account agreement -- common in the industry -- prevents her from suing over the charges or the practice, the bank says.

How did we get to this point?

Thank our reliance on the debit card, our own poor financial management and lax regulatory oversight.

We now do three out of four transactions electronically, Moebs said, compared with one in three just 15 years ago. Yet only about one in eight of us reconciles our checking account.

Federal regulators don't consider overdraft fees to be finance charges because they don't vary in amount, says Brian Melzer, associate finance professor at Northwestern University. That omits them from the federal Truth in Lending Act, which would require banks to prominently disclose the interest rate and abide by caps.

Consumers, regulators and lawmakers are acting on several fronts to change this practice:

Speers' lawsuit has been consolidated in Florida with at least a dozen others filed against big banks, including Bank of America and Citibank Inc.

Congress is considering capping overdraft fees at an equivalent 36 percent annual yield -- the same limit now in place for credit extended to military members and

Jonathan Zinman, associate economics professor at Dartmouth College.

However, "a consumer doing this would want to be extra careful to not write bad checks," Zinman warns. Bounced checks can lead to even higher fees and potential criminal prosecution.

Sign up for linked accounts and alerts.

Many banks will link your checking account to a savings account, a line of credit or a credit card. Fees for such services are much lower, if any. But most make you ask.

Many credit unions, including OnPoint Community Credit Union and Unitus Community Credit Union in Portland, do this automatically, for free, upon account setup. OnPoint and Unitus customers also can sign up for free e-mail alerts each time their balance falls below, say, \$100.

Interestingly, Unitus plans to drop its overdraft fee from \$29 to \$26 by year's end, said Laurie Kresl, the institution's vice president of planning and business development. "Times are tough right now," Kresl said. "By taking this step, we may be able to help our members manage through it all."

Use a credit card instead. A \$50 balance on a credit card charging 18 percent interest will cost you less than \$3 in interest over three months, said Victor Stango, professor of economics at the University of California at Davis Graduate School of Management.

their families. Another bill would require banks to get written consent for overdraft loans and prohibit reordering transactions from largest to smallest. Senate Banking Committee member Jeff Merkley, D-Ore., figures to have say on these bills' fate.

As of Jan. 1, federal rules require banks to clearly disclose overdraft service fees on bank statements. Since March, the Federal Reserve has been considering going further, requiring customers to opt in to overdraft protections rather than being enrolled automatically.

"When this was paper checks, (an automatic overdraft loan) was a good thing," said Marc Fusaro, assistant economics professor at Arkansas Tech University who studies banking. "You didn't want people intentionally bouncing a check. But now that it's debit cards, I'm not sure it's a good thing."

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Overdrawing that amount costs more than 10 times as much at large banks.

"Using a credit card, even if you don't repay the charge immediately, is a much cheaper way to pay for things when your checking balance is low or negative," Stango said.

Move your money elsewhere. Remember, when you deposit money, you're loaning it to the bank. If you don't like how it treats that loan, become an underwriter and deny it.

Community banks and credit unions, generally speaking, charge lower overdraft fees, offer free protections from overdrafts and often forgive fees for customers who rarely overdraw. "There's a whole lot of banks who are competing for deposit accounts right now," said Linda Navarro, president of the Oregon Bankers Association. "Folks ought to shop around."

Check your balance often. Look online or via phone. Unfortunately, only about one in eight of us balances our accounts regularly, said Jean Ann Fox, director of financial services at the Consumer Federation of America.

Remember also that merchant-authorized transactions don't necessarily show up right away as being deducted from your account. But they can still trigger an overdraft charge.

Use cash. You might spend more when you use plastic. Cash -- particularly larger bills -- can curb your spending,

research suggests.

What do you do? Share your overdraft avoidance tactics below.

--*Brent Hunsberger*