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Altering Overdraft Fee Policies to Promote Consumer Financial Health

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by

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Introduction

Banks across the country have relied heavily on service charges on checking and savings accounts for years. In 2021, banks earned $34 billion dollars in deposit service charges, and these fees have been increasing over time *(FFIEC Call Reports*). The banking industry argues that these fees promote consumer financial responsibility and wellness because they hold customers accountable for their financial health by charging an overdraft fee for charging more to their accounts than they can afford. On the other hand, many claim that this fee harms consumers, especially those with low income. Overdraft fees falls on low-income communities that typically struggle to cover everyday costs and living expenses, resulting in occasional or frequent overdrafts on their accounts. According to the Consumer Financial Protection Bureau, less than 9% of consumers bear the weight of 10 or more overdrafts per year, which accounts for 80% of all overdraft revenue (*Consumer Financial Protection Bureau, 2018*).

A recent trend in the financial industry is to move towards financial products that are more equitable and inclusive. More than ever, consumers are holding large corporations accountable for their social and environmental impact. Government officials across the country are joining consumers in challenging corporations to alter their practices and strategies to become more accessible. One area that has received significant attention is overdraft fee policies. Many banks eliminated or reduced service charge fees during the COVID-19 pandemic to alleviate depositors of additional financial burden, but as COVID-19 conditions ease, will deposit charge fee leniency ease as well?

Discussion of overdraft protection and overdraft fees are often confused. *Overdraft protection* is a product provided by banks to depositors in advance to cover charges made against a transaction account with too little funds to fully cover the charge. The bank links another account of the customer at the bank to transfer funds to the transaction account, or the bank lends the money to the depositor to complete the transaction and charges interest income on the loan. Not all banks offer overdraft protection but if they do, depositors must explicitly opt-in to the service. *Overdraft fees* are charged by the bank when the depositor's account is overdrawn and the account has no overdraft protection. Banks have the option to clear or decline payment on the customer's behalf. If the bank declines payment, the depositor could be charged an additional "bounced check" fee by the counterparty in addition to the overdraft fee.

In the changing societal landscape, citizens and regulators are questioning the morality of the increasing bank profits from overdraft fees. In addition, financial technology companies such as Chime are demonstrating that they can provide innovative products that do not generate revenue from consumer financial hardships. The emergence of these products challenge whether overdraft fees are necessary to impose on the consumer by showing other ways to help consumers achieve financial health that do not disadvantage individuals with low income. In response to these pressures, several large banks have begun to alter polices to present more inclusive and equitable business models.

The objective of this study is to describe the traditional overdraft practices, explain the reaction of the banking industry from the pressure coming from consumers, regulators, and innovative companies to reduce or eliminate overdraft fees to promote consumer financial health.

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The Walton College of Business and Walton Honors program adequately equipped me over the years to complete and defend a dissertation of my choosing and propels me to future success after graduation.

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Industry Trends in Bank Overdraft Fees and Policy

In the banking industry, deposit service charges include overdraft fees, maintenance fees, ATM fees, and other fees. Maintenance fees are periodic (usually monthly) charges to depositors for their active accounts at their particular bank. Automated Teller Machine fees (ATM fees) are for ATM services, and "other" fees may be comprised of any other fee not listed such as excessive transactions fees, wire transfer fees, or early account closing fees (*CNBC*).

The focus of this study is on overdraft fees, which differ from overdraft protection. Overdraft protection is a product provided by banks that enables consumers to open a small line of credit with the bank or draw funds from another linked account when a transaction is made on an account with insufficient funds. Banks typically charge customers for this service, but it is treated as a loan rather than a fee. In contrast, overdraft fees are charged to depositors who overdraw their accounts and are not covered by overdraft protection.

Congress and bank regulators have been attempting to rein in overdraft fees for some time. In 2010, the Office of the Comptroller amended Regulation E, 12 C.F.R. Part 205, which made changes to better protect consumers from overdraft fees *(Office of the Comptroller*). It mandated that banks acquire consent to opt depositors into overdraft protection that subjects them to notices if they are at risk for overdraft fees. According to the Consumer Financial Protection Bureau, under § 1005.17(b)(1), banks must provide customers "notice in writing about overdraft fees, reasonable opportunity for the consumer to affirmatively consent or opt-in to the overdraft protection service or provide proof of the consumer's consent in writing and inform them of the freedom to withdraw consent before the bank can assess any overdraft fees on ATM or debit transactions" *(Consumer Financial Protection Bureau, 2021*).

Despite the tighter regulations, deposit service charges rose between 2011 and 2019 as shown in Figure 1. However, they fell sharply with the onset of the pandemic driven by a decline in overdraft fees. In 2019, the banking industry collected $33.5B in deposit service charges including overdraft fees of $11.7B (FFIEC Call Reports). Overdraft fees, however, dropped to $8.8B in 2020.[1] The trend in overdraft fees between 2015 and 2021 is also shown in Figure 1.

During the COVID-19 pandemic, the Biden administration executed relief efforts to alleviate potential financial burden in the case of a leave of absence due to COVID-19 diagnosis or exposure. The relief efforts included stimulus payments and the Paycheck Protection Program. According to the Department of the Treasury, "three rounds of fast and direct relief payments during the various phases of the COVID-19 crisis" were made to American citizens (*Department of Treasury*). "The Paycheck Protection Program is a loan program that originated from the Coronavirus Aid, Relief, and Economic Security (CARES) Act. This was originally a $350-billion program intended to provide American small businesses with eight weeks of cash-flow assistance through 100 percent federally guaranteed loans," and specifically targets supporting business payrolls as stated by the bill H.R.748 - CARES Act (Yin, Bench). These relief efforts resulted in an increase in consumer deposit accounts across the country, reducing overdraft occurrences and banks' reliance on overdraft services. The direct impact of overdraft policy amendments is blurred by the impact of COVID-19 relief stimulus packages.

The banking industry is experiencing external pressures now more than ever from regulators, societal shifts in consumer preferences, and the emergence of innovative financial

[1] The breakdown of deposit service charges is reported in the call reports only for banks with over $1B in assets, but the reporting banks account for roughly 95% of all banking assets.

technology products, forcing banks to confront their reliance on overdraft fees. The Consumer Financial Protection Bureau and several government officials are concerned that overdraft fees target low-income consumers (*Marshall, Elizabeth, Reuters*). Accessibility and equity efforts seemingly accelerated and became more wide-spread during the COVID-19 pandemic. While some banks made changes to their overdraft policies during this time, is this reduction permanent?

Four banks - Bank of America, Wells Fargo, Citibank, and JPMorgan - collected 44% of industry overdraft fees (*Consumer Financial Protection Bureau,2021).* These four banks, the so-called "Big Four," dominate the industry by size. Figure 2 displays the industry deposit share breakdown, and it shows that the Big Four held 48% of industry deposits in 2021. The efforts of these banks to reduce overdraft fees, therefore, will have big effects on the industry as a whole.

FIGURE 1: Industry Service Charges (2015-2021)

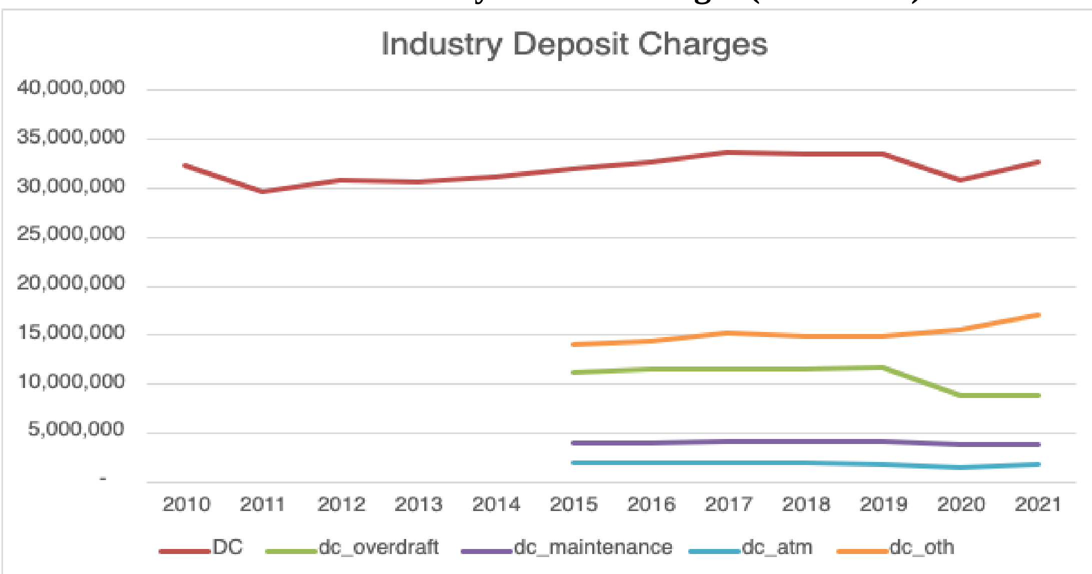
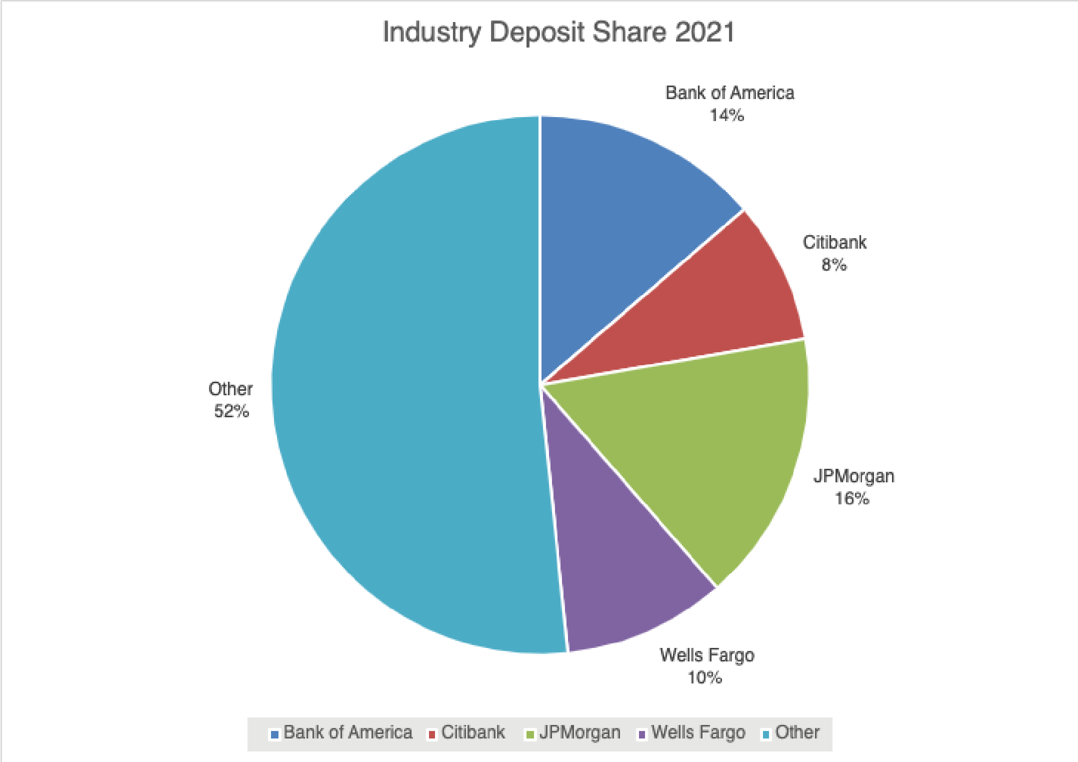


Figure 2: Industry Deposit Share in 2021



Source: FFIEC Call Reports

Overdraft Policies of Financial Technology Companies

Digital banks, also known as "neobanks," and financial technology companies are applying pressure to the traditional banking system on overdraft fees because they are providing alternative financial products to show that there are other means of guiding customers to financial responsibility. The emergence of alternative banking options and products gives depositors more choice and exposes traditional banking to a more competitive landscape. Founders of financial technology company competitors, such as Chime's founder Chris Britt, claim that traditional banks are not capable of imitating the business models of their modern and innovative competitors. These companies continue to grow their portion of market share in the banking system as it undergoes a digital transformation. According to Grand View Research, the neobank market "was valued at 47.39B USD in 2021 and expected to grow at a compound annual growth rate of 53.44% through 2030" (*Grand* View, 2021). In addition to the politically charged shift in consumer behavior, depositors are also being driven by the convenience and seamlessness of digital banking.

Ally Bank

Ally Bank, capturing 9% of digital banking market share, prides itself by eliminating its overdraft fees in June of 2021. Ally Bank strives to guide responsible customers with an Overdraft Transfer Service, which transfers $100 increments to the overdrawn account from a linked savings or money market account (*Ally Bank Website)*. In addition, CoverDraft, Ally's new product, allows customers a temporary, fee-free $100 when needed. The Overdraft Transfer

Service and CoverDraft can work together to ensure the customer can cover their common transactions. The customer must bring their account out of a deficit, and if the deficit remains for 45 days or more, it may be closed (*Ally Bank Website)*. If a customer's account is not eligible for these products and a transaction that exceeds the sum that resides in the account, the transaction will be declined.

Chime

Chime, a financial technology company that partners with banks to provide a variety of services, covers 35% of all digital banking accounts (*Shevlin, Forbes 2021)*. Chime advertises unique consumer-focused features such as early access to paychecks, a short-term loan program called "SpotMe", and a credit card that assists customers in building their credit. The financial technology company capitalizes on the controversy surrounding overdraft fees and denounces the traditional banking system for profiting from them. The company offers customers access to their paychecks up to 2 days early. During the COVID-19 pandemic, customers of Chime also had early access to their tax returns and federal stimulus checks. The "SpotMe" feature is offered to customers with over $500 in monthly direct deposits and enables them to overdraw on their account without the penalty of an overdraft fee. Based on activity and history with Chime, customers are eligible to overdraw certain amounts free of charge to meet liquidity needs (*Shevlin, Forbes 2021)*. Chime's main customer demographic is low- to middle-income households and the credit-building credit card is a feature that accommodates this group. The CEO of Chime explained that traditional banks would struggle to imitate Chime and other financial technology companies' business models because of the high account management fees the banks face.

Proposed Legislation on Overdraft Policy

Reflecting the societal shift demanding more accessibility and equity in financial services, government representatives are proposing bills to combat the inequities in banking. Overdraft services and fees are an important focus in the bills, as many of them highlight the disproportionate impact overdraft fees have on families of color and low-income.

In June of 2021, representative Carolyn B. Maloney introduced a new bill, H.R.4277, the Overdraft Protection Act of 2021. The bill describes Congress' findings surrounding exploitative bank overdraft protection services and highlights that while traditional banks provide many innovative products for depositors, they "aggressively encourage consumers to consent to the most expensive option, where a high flat fee is collected for every individual overdraft transaction." (U.S. Congress) The bill calls these practices "abusive" and claims that overdraft fees disproportionately target middle-to-low-income families, especially Latino or African American families. The purpose of the Overdraft Protection Act of 2021 is to "protect consumers by limiting abusive fees and practices" by commanding banks to express more thorough disclosures to consumers.

The Overdraft Protection Act of 2021 presents mandatory rules that banks must follow to promote consumer financial health and educated decision making. The bill prohibits banks from engaging in acts in "connection with the marketing or provision of overdraft coverage that are unfair, deceptive, or designed to evade the provisions" of the bill (*Congress*). It also mandates that banks that provide overdraft protection services "shall clearly and conspicuously disclose all marketing materials," specifically mentioning that consumers that decide to opt-out of overdraft protection services are made aware that transactions charged to their accounts with insufficient funds will be declined, which will not result in an overdraft fee (*Congress*). The bill addresses the methods of recording consent from depositors at banks, requiring consent electronically, in writing, or any other method allowed by the Consumer Financial Protection Bureau.

Carolyn B. Maloney and counterparts propose additional disclosures in relation to overdraft fees that must be clearly communicated to depositors at banks. The disclosures include:

> "(A) the consumer may be charged for not more than one overdraft coverage fee in any single calendar month and not more than 6 overdraft coverage fees in any single calendar year, per account; and
> "(B) the financial institution retains the discretion to pay (without assessing an overdraft coverage fee) or reject overdrafts incurred by the consumer beyond the numbers described in subparagraph (A);
> "(2) the overdraft coverage fee as an annual percentage rate, so as to permit consumers to meaningfully compare the overdraft coverage to alternative forms of overdraft options and other sources of credit;
> "(3) information about any alternative overdraft products that are available (such as linked accounts, lines of credit, and alerts), including a clear explanation of how the terms and fees for such alternative services and products differ; and
> "(4) such other information as the Bureau may require, by rule."

Under the Overdraft Protection Act of 2021, banks must also promptly notify their customers of all details regarding overdraft charges to their accounts including: "date of transaction, type of transaction, the overdraft amount, the overdraft coverage fee, the amount necessary to return the account to a positive balance, and whether the participation of a consumer in an overdraft coverage program will be terminated if the account is not returned to a positive balance within a given time period." Depositors must also be presented with the following limits: "notice and opportunity to cancel, frequency, reasonable and proportional overdraft fees, and posting order." The notice and opportunity to cancel limit mandates that banks warn customers when a transaction triggers an overdraft fee, providing them the opportunity to cancel the transaction upon receiving that information. The frequency limit states that depositors may not be charged more than one overdraft fee per day and no more than six per year. Overdraft fees charged to depositors must be reasonable and proportionate to the total of the overdraft transaction and the cost to the bank for providing funds to cover the overdraft transaction.

The Overdraft Protection Act of 2021 is cosponsored by 46 other representatives and has been introduced to the House. The bill reflects and responds to the societal shift taking place in the United States of America towards inclusivity and accessibility for all.

Response by the Big Four

In light of increasing controversy due to a societal shift towards inclusivity and equity, and external pressure by financial technology companies and digital banks, some traditional banks have made changes to their overdraft protection products and fees. Because of their importance to the industry, I discuss how each of the Big Four banks at the center of the controversy has responded.

Bank of America

In the CFPB report, Bank of America's reliance on overdraft is listed as 51.6% in 2019, making it the least reliant on overdraft of the big four (*Consumer Financial Protection Bureau, Call Report 2021).* Bank of America charges consumers an overdraft fee of $35 when overdrawing their accounts regardless of the amount of the transaction (*Bank of America).* In February 2022, the bank removed the ability to overdraw accounts at the ATM (*Bank of America).* In May 2022, Bank of America will reduce this fee to $10 and eliminate the $12 fee for overdraft protection (*Marshall, Elizabeth, Reuters).* In wake of the reduction in overdraft fees, Bank of America launched new financial products, *Balance Assist*, *Safe Balance* and *Balance Connect* to support customer financial needs. Balance Assist allows customers to draw a short-term loan up to $500 for a $5 fee, all of which must be repaid in equal payments within 90 days. Safe Balance is a checking account that does not charge overdraft fees. Balance Connect extends overdraft protection for up to five connected accounts at Bank of America (*Bank of America).* The bank has been outspoken about their commitment to serve consumers better and pursue alternatives to overdraft affiliated fees.

Wells Fargo

Wells Fargo has the second highest reliance on overdraft of all major banks with overdraft making up about 67% of all deposit service charges in 2021 (FFIEC Call Report data). In 2020, during the pandemic, Wells Fargo offered customers a grace period for repaying their overdraft fee and deficit on their accounts (*SEC 10K)*. As the world has recovered from the pandemic, the leniency has lifted, and the bank will keep the overdraft fee at $35. Wells Fargo has been the target of government figures such as Elizabeth Warren for exploitative overdraft fees (*Warren)*. Warren called on the Consumer Financial Protection Bureau to pursue regulatory action on the Big Four for their overdraft policies (*Warren).* Warren helped push the "Stop Overdraft Profiteering Act of 2021" that would prohibit overdraft fees on debit transactions, prohibits banks from reordering transactions to cause overdraft and multiple instances of overdraft fees, and educate consumers better on overdraft protection policies (*Warren)*.

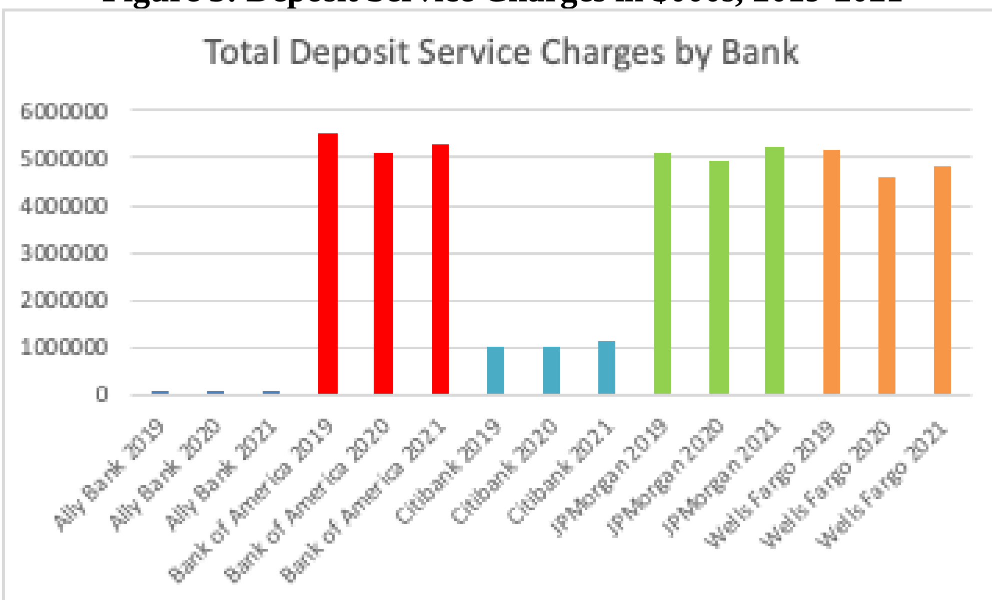
Citibank

In 2020, Citibank collected $100 million in deposit-related fees including overdraft fees (*SEC 10-K Filing).* According to a Citibank blog post, overdrafts are not permitted even if the customer does not have sufficient funds unless they choose to opt-in. Citi provides customers low-balance alerts and offers an overdraft line of credit for a $10 transfer fee, but customers are offered the option of drawing that line of credit at the point of sale to promote consumer financial control. (*Citibank)* The Citibank website highlights one of their fastest growing products, The Access Account, which is a checking account with little or no fees including overdraft fees, and it allows customers to waive a monthly account fee to cater to younger and low-income individuals. (*Citibank, 2018 Annual Report)*

JPMorgan

The CFPB indicates that JPMorgan exhibited the highest reliance on overdraft fees at around 69% of their overall deposit service charges in 2019. (FFIEC Call Report) JPMorgan collected $4.7B in overdraft fees throughout the COVID-19 pandemic (FFIEC Call Report*).* In light of the heightening controversy surrounding the revenue made off of these fees, JPMorgan has made "enhancements" to their accounts. One enhancement includes increasing the overdraft allowance to $50 which allows depositors to draw a deficit up to $50 free of charge but charges a fee for any transaction that results in a deficit for more than $50 at the end of the business day. (*JPMorgan)* Another enhancement is eliminating the returned item fee which does not charge customers a fee for not making a payment because they do not have enough funds. The others include providing customers early direct deposit which gives them access to their wages early and providing customers a day to bring their overdrawn balance to below $50 before an overdraft fee is charged to their account. With these enhancements, JPMorgan claims to have helped two million customers avoid overdraft fees. (*JPMorgan)*

Figure 3: Deposit Service Charges in $000s, 2019-2021



Despite amendments to bank policy and COVID-19 leniency, trends in deposit service charges vary by bank for the years of 2019-2021. Figure 3 displays total deposit service charges for each of the Big Four plus Ally Bank to provide a comparison to a large online bank. The figure reveals that total deposit service charges remained steady across all focus banks 2019 to 2021. Bank of America and Wells Fargo's total deposit service charges declined slightly, but Citibank and JPMorgan's deposit charges increased.

FIGURE 4: Share of Deposit Service Charges by Component in 2019 & 2021

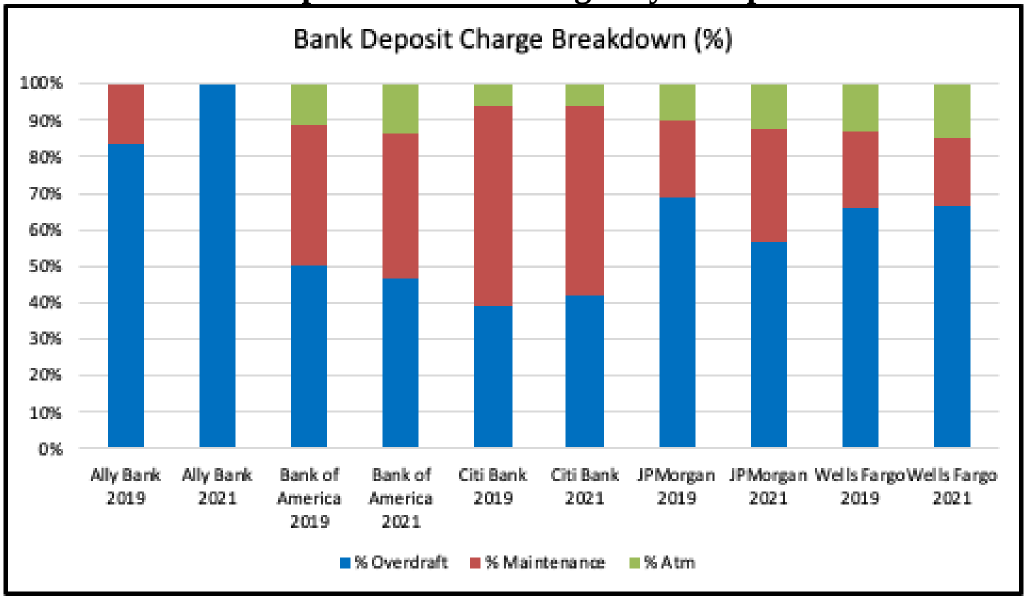
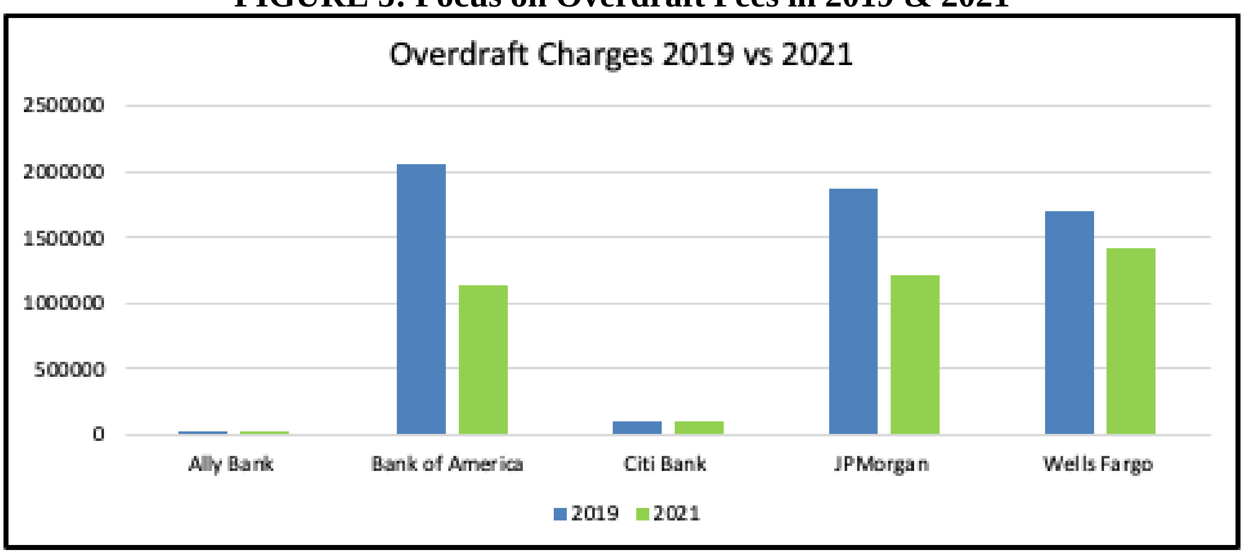


Figure 4 exhibits the Big Four and Ally Bank deposit service charges breakdown in percentages of overdraft, maintenance, and ATM fees. Ally Bank and Citibank's reliance on overdraft fees increased from 2019 to 2021, but the total deposit service charges collected by these banks are significantly less than the other focus banks. Bank of America and JPMorgan's reliance on overdraft fees as a percentage of total deposit charges decreased from 2019 to 2021. Wells Fargo's reliance on overdraft remained steady.

FIGURE 5: Focus on Overdraft Fees in 2019 & 2021



Finally, Figure 5 plots the banks' overdraft charges in millions of dollars in 2019 and 2021. Ally Bank and Citibank charge very little overdraft fees overall and the amount is similar across the years. Bank of America, JPMorgan, and Wells Fargo each show a decrease in overdraft charges in 2021 compared to 2019. Bank of America reported a $9.26B decline in overdraft charges from 2019 to 2021. JPMorgan and Wells Fargo also reported decreases in overdraft fees of over $2.5B. Citi Bank and Ally Bank reported the lowest overdraft charge totals less than $2B.

The figures show that the Big Four collected less overdraft fees from 2019 to 2021. The cause of the decreased reliance could be from changes in the policies at each of the banks surrounding overdraft protection.

Conclusion

Banks across the country are faced with widespread criticism surrounding overdraft fees from depositors, fintech companies, and regulators. Industry overdraft fees did decline by $2.9B between 2019 and 2021; however, this decline was driven at least in part by a surge in deposits at major banks from COVID-19 stimulus payments, which provided customers with higher balances and fewer overdrafts. It is unclear how much of the decline was due to voluntary actions by individual banks.

Financial technology companies and digital banks such as Chime and Ally Bank continue to apply pressure to the traditional banking system by developing innovative and individualized financial products as alternatives to overdraft fees to increase competition and capture market share. Considering the societal shift of consumers aligning their dollars with their values, financial technology companies and digital banks may capture more market share as consumers utilize the innovative and feature-focused products they have to offer.

Regulators and senators continue to propose legislation to promote consumer financial health in the banking system. The bills introduced to the house demand financial product transparency and disclosure to depositors. Changes were made to overdraft protection in 2010 and the bill that has more recently been proposed aims to make additional changes to overdraft protection services at banks. In response to the external pressure, some of the largest banks like Bank of America, JPMorgan, and Citibank have responded to the pressure by providing additional financial products or reducing or eliminating overdraft fees to promote consumer financial health. Other banks like Wells Fargo permitted temporary leniency on overdrafts for their depositors, but as the pandemic lifts and life returns to semi-normalcy, the bank is returning to its normal overdraft service policies. In the future, with the help of collective societal pressures and regulations, depositors may be more informed on how to avoid overdraft fees and achieve their financial goals. Banks will likely generate revenue in other ways by means of innovative services or products to compete with financial technology companies and digital banks. It is likely that financial technology companies and digital banks will grow in popularity due to the societal shift of preference for customizable user experiences and convenience.

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