

Overdraft Protection on Your Checking Account: Information for PFC Counselors

Institutions that operate fee-based overdraft loan programs extend credit by paying customers' checks, debit cards transaction, or ATM withdrawals when customers have insufficient funds in their accounts. The institution pays the amount of the overdraft, and charges the customer a fee that ranges from \$20 to \$35. **NOTE: As of July 1, 2010, financial institutions must ASK customers if they want overdraft protection. If they do NOT, the financial institution cannot charge fees on overdrafts it pays on ATM and one-time debit card transaction – and likely will decline those transactions for insufficient funds.**

If a customer accepts automatic overdraft protection and is overdrawing her account through an ATM withdrawal or debit purchase, generally the institution will neither notify the customer of this fact nor give her the option to cancel the transaction. When the customer's next deposit is made to her account, the institution debits the amount of the overdraft, plus the fee.

As a result of the high fees and short repayment time, borrowers pay triple- and even quadruple-digit interest rates. For example, if the overdraft loan fee was calculated as an APR, a \$22.50 fee for an \$80 overdraft loan translates into a 1,467% APR for a loan paid back in a week and a 733% APR if the loan is repaid in two weeks.

An institute has a fee-based overdraft loan program (as opposed to a policy of paying a customer's overdrafts on an occasional ad hoc basis) if it does any of the following: 1) pays overdrafts for more than one incident per quarter; 2) knowingly allows overdrafts through ATMs, debit cards, or other non-check withdrawals; 3) advertises the existence of an overdraft program; or 4) communicates to the customer that she has a monetary limit to any overdraft coverage. Programs that provide contractually guaranteed protection to customers, such as links to lines of credit, are not overdraft loan programs for purposes of this paper.

A Borrower's Experience

A few days before Christmas 2004, Mr. Morgan used his bank check card to make a small purchase at a grocery store. He didn't realize that his checking account balance was too low to cover the debit. When his check card was accepted, he assumed that he had sufficient funds in his account. Over the course of the next three days, Mr. Morgan used his check card for a number of purchases. For each transaction, his bank charged a \$30 fee—but the bank did not tell him that his account had a negative balance.

When Mr. Morgan reached the \$600 limit of his bank's overdraft loan program, his debit card transactions were finally declined. By that point, Mr. Morgan had racked up \$300 in overdraft fees for \$239 in purchases. When he contacted the bank, he was told that the bank had paid the overdrafts as a courtesy. Mr. Morgan had never signed up for an overdraft loan program and was angry that he'd been charged \$300 for a "service" he didn't want.

Source: Center for Responsible Lending. 2005. High Cost and Hidden From View: The \$10 Billion Overdraft Loan Market. <http://www.responsiblelending.org>.