

# Overdraft Regulation: A Silver Lining to the Clouds?

**Adam J. Levitin**

*Associate Professor  
Georgetown University Law Center*

**filene**  
RESEARCH INSTITUTE



Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process.

The Filene Research Institute is a 501(c)(3) not-for-profit research organization dedicated to scientific and thoughtful analysis about issues affecting the future of consumer finance. Through independent research and innovation programs, the Institute examines issues vital to the future of credit unions.

Ideas grow through thoughtful and scientific analysis of top-priority consumer, public policy, and credit union competitive issues. Researchers are given considerable latitude in their exploration and studies of these high-priority issues.

Traditionally, the Filene Research Institute focuses on long-term research questions that can take months or years to research and publish. Occasionally Filene also publishes Research or Innovation briefs. These briefs allow Filene to present important, time-sensitive, notorious, and unbiased topics to the credit union system. Oftentimes these briefs present an opportunity to distribute original research or innovation findings from Filene researchers or Fellows. We hope the “brief” format meets your need to obtain actionable and objective information in a timely manner.



### **Adam J. Levitin**

Adam J. Levitin is an associate professor of law at Georgetown University Law Center in Washington, D.C., where he teaches courses in bankruptcy, commercial law, contracts, and structured finance. He also serves as special counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program. In the fall of 2009, Professor Levitin was the Robert Zinman Resident Scholar at the American Bankruptcy Institute.



By Ben Rogers,  
*Research Director*

Unlike with an avoidable airplane crash or the collapse of a bridge, there was no public moment that sealed the fate of laissez-faire overdraft rules. Instead, new rules have been written by increasingly cautious regulators responding to consumer anger over lending practices, government bailouts, and inscrutable banking fees. Fully 50 million Americans paid overdraft fees in the 12 months running through mid-2009. And the poorest 10% of Americans pay 90% of the fees. The new overdraft rules—in the form of Federal Reserve Board regulations and perhaps even stronger Congressional action—are almost certainly here to stay.

This Filene Research Institute report, *Overdraft Regulation: A Silver Lining to the Clouds?*, is written by Adam Levitin, associate professor at the Georgetown University Law Center in Washington, D.C. As suggested by the title, Levitin recognizes the significant changes that will flow from the new rules and provides specific insights on the financial effects of the changes on individual credit unions, but he also offers clear options for plotting a course through this new bank of clouds. This brief examines the potential impact of overdraft regulation on credit unions, but it does not take a position regarding the regulation.

### What Did the Researcher Discover?

Two overdraft actions loom over credit unions. The first, an amendment (the overdraft rule) to Regulation E under the Electronic Fund Transfer Act, was enacted in November 2009 and will require that consumers affirmatively opt in to discretionary overdraft protection for ATM and point-of-sale (POS) debit card transactions. It goes into effect for new accounts on July 1, 2010 and for existing accounts on August 15, 2010. The second action, proposed legislation in both the House and the Senate, is much more sweeping. It would require consumer opt-ins for all overdraft coverage, not just debit and ATM overdrafts. The bills would limit the number of overdraft fees, limit fees to a “reasonable” amount, prohibit some overdraft fees from debit transaction holds, require same-day notification of fees, and prohibit NSF fees for debit and ATM transactions.

Because the changes are coming so quickly, we agree with Carveth Read, a nineteenth- and twentieth-century British logician who wrote, “It is better to be vaguely right than exactly wrong.”<sup>1</sup> In the interest of time, that is the approach Filene has taken in soliciting information and insights about the changes in overdraft rules. This report compares a 185-respondent credit union survey with in-depth legal and marketplace research. The result: an analysis of the

proximate changes and an estimate of their effects on credit unions. The numbers presented are vaguely right; rather than being absolutely precise, they are immediately useful.

Using far-ranging research and the results from Filene's in-depth survey, Levitin finds that:

- For those credit union members who do overdraft, overdrafts are quite common. The median (mean) percentage of members with multiple overdrafts is 11% (19.13%). Repeat overdrafters are clearly the most profitable: Of those who paid overdraft fees in 2009, the median total paid was \$238.25.
- Overdrafts are spread out evenly among paper checks and ACH and POS debit transactions, with each accounting for about one-third of overdrafts. ATM overdrafts are negligible at most respondent credit unions.
- The survey indicates that credit unions receive a smaller percentage of their overdrafts from POS debit and ATM transactions (33%) than do banks (41%). Half of respondents process transactions chronologically in order of presentation; 29% process them by size from smallest to largest and 16% process from largest to smallest.

## What Are the Implications for Credit Unions?

The overdraft rule and the overdraft bills would have very different impacts on credit unions. That's mainly because the pending Fed rule limits itself to POS debit and ATM transactions and only seeks opt-in. The proposed legislation, on the other hand, advocates sweeping changes that would regulate everything from processing procedures to the number of times firms are allowed to charge fees to consumers each month.

The financial impact of the overdraft rule will largely depend on the opt-in rate credit unions achieve, particularly among the subset of members who generate the most overdrafts. Other implications from the survey:

- Assuming, in a worst-case scenario, that no members who do not currently opt in to overdraft would opt in, total fee income could sink by 11%.
- From 2004–2009Q2, the loss of all overdraft revenue from debit and ATM transactions would have had an impact of around 9 basis points (bps) on credit union ROA.

- The rule's effect will likely be much more damaging for credit unions smaller than \$100 million (M) because they earn lower average ROAs.

Levitin suggests various responses to the new overdraft landscape. Credit unions can:

- Reconsider their fee structure for accounts, particularly free checking accounts.
- Bundle accounts to introduce different revenue streams into standard transaction accounts.
- Offer only the basics for free with a la carte pricing for additional services or product features.
- Simply live with the diminished margins.

The report suggests that the worst-case implications of the overdraft rule would entail a tangible drag on earnings, but it should not destroy the current business model. The overdraft bills, the futures of which are uncertain, would almost certainly be much harder to swallow.



Overdraft fees have become a major source of financial institution revenue in recent years. Total overdraft fees rose from \$10.3 billion (B) in 2004<sup>2</sup> to an estimated \$38.5B in 2009.<sup>3</sup> Prior to 2005, overdraft services were largely unregulated, but in recent years, they have become the target of significant regulatory attention.<sup>4</sup> This is in part because of the rapid growth in overdraft programs and fees. It is also because of the widespread impact of overdraft fees (more than 50 million Americans paid overdraft fees in a single 12-month period, with 27 million accounts incurring five or more overdraft fees<sup>5</sup>), their cost (effective annualized interest sometimes exceeds 3,500%<sup>6</sup>), their disproportionate impact on the least wealthy depository customers (the poorest 10% of customers pay 90% of overdraft fees<sup>7</sup>), concerns that consumers are poorly informed about the overdrafts, and concerns that some financial institutions manipulate transaction processing to generate more overdrafts.

More than 50 million Americans paid overdraft fees in a single 12-month period, with 27 million accounts incurring five or more overdraft fees.

In response to these concerns, the Federal Reserve Board (FRB) and National Credit Union Administration (NCUA)

passed parallel overdraft disclosure and advertising regulations in 2005.<sup>8</sup> The FRB and NCUA expanded the regulations' applicability in early 2009,<sup>9</sup> and in late 2009, the FRB passed a regulation governing banks and credit unions that requires consumers to opt in to certain overdraft protection services offered in connection with electronic funds transfers.<sup>10</sup> Much further-reaching legislation has been proposed in both houses of Congress, including a bill sponsored by

Senator Christopher Dodd, the chairman of the Senate Banking Committee.

The poorest 10% of customers pay 90% of overdraft fees.

This research brief reviews the FRB and NCUA regulations and proposed legislation and considers their likely impact on credit unions. In particular, the analysis in this research brief utilizes a unique survey of 185 credit unions regarding their overdraft programs. Previous studies of overdraft fees have focused on commercial banks and thrifts; credit union overdraft fees have not been examined in this much detail before.

## Overdraft Overview

### Types of Overdraft Programs

Traditionally, when a consumer wrote a check against a deposit account that held insufficient funds for the transaction, the bank would dishonor the check. Both the bank and the presenter might charge the consumer a "bounce" or nonsufficient funds (NSF) fee.

Some financial institutions, however, would permit overdrafts to valued customers on a discretionary, ad hoc basis as a courtesy.

From this informal banking practice for checks and similar instruments, a much more complex set of overdraft services has developed. Today, overdraft services apply not only to checks, but to all draws on deposit accounts: checks, automated clearinghouse (ACH) items, debit card transactions, and ATM withdrawals. The expansion of transaction media also changes the circumstances in which overdraft services apply. Overdraft protection on a check traditionally did not kick in until a few days after the check was tendered in payment for goods or services. The consumer did not face the potential embarrassment of a denied transaction at point of sale (POS) and had some time to address urgent liquidity needs. For debit and ATM transactions, however, overdraft protection has a different impact. The ability to overdraw provides consumers with access to funds in urgent situations and helps them avoid the embarrassment and inconvenience of transactions denied at POS.

The nature of overdraft services has also expanded. In addition to the traditional ad hoc overdraft credit, there are now three other types of overdraft services offered. First are linked-account overdraft programs. In these programs, if a consumer overdraws his or her checking account, funds from another linked account, such as a savings account, are used to cover the overdraft. Only if all linked account funds are exhausted is the overdraft denied.

Second are formal overdraft lines of credit, which merely substitute a line of credit for a linked funded account. When a consumer overdraws his or her account, the overdraft is automatically covered by the line of credit, up to the line's limit. Formal overdraft lines of credit are subject to the disclosure requirements of the Truth in Lending Act<sup>11</sup> and Regulation Z (Reg Z).<sup>12</sup> In many Western countries, formal overdraft lines are a major source of consumer credit.

Finally, there are automated overdraft programs that allow overdrafts that fit preset criteria. Automated programs are discretionary extensions of credit, unlike line-of-credit overdraft programs; the criteria for permitting automated overdrafts are under the financial institution's control, rather than part of a credit

Overdraft fees now account for almost three-quarters of total service charges imposed on deposit accounts.

agreement. The main benefits of automation are its elimination of the cost of manual review and its consistency in consumer treatment. Most overdraft protection services are now discretionary, automated programs.

With the expansion of overdraft services, overdraft fee income has increased dramatically, growing to nearly \$40B in 2009. Overdraft fees now account for almost three-quarters of total service charges imposed on deposit accounts.<sup>13</sup>

### Concerns About Overdraft Fees

As overdraft fees have become more frequent, several complaints have emerged. First is simply that they are overpriced. Overdrafts are typically very short extensions of credit with flat fees, but if these fees are annualized into an interest rate, they often result in rates of well over 1,000% APR. The APR depends on the amount of the overdraft and the length of time it is outstanding, but assuming a \$27 fee on a \$20 overdraft that is repaid in two weeks, the APR would be a staggering 3,520%. The fee levels on overdraft do not appear to relate to actual costs or risks to the financial institution. At many institutions, two \$10 overdrafts result in more fees than a single \$20 overdraft or even a single \$100 overdraft, although the risk posed to the institution by the two overdrafts is smaller.

Overdraft fee levels do not appear to be competitively set. Instead, they appear to reflect the quasi-monopoly pricing power a financial institution has over its depositors because of the substantial lock-in effect. The rapid increase in fee levels in recent years, which has occurred without any apparent impact on banks' market share, indi-

cates that overdraft protection is not a competitive market.

Second, consumers are often unaware of the discretionary nature of automated overdraft.

Automated overdraft is a “cour-

tesy” extension of credit, not subject to TILA or Reg Z. Consumers are therefore unable to know whether their transactions will be denied for NSF or honored, but with an overdraft fee. They are also frequently unaware of whether they can decline automated overdraft protection.

Third, consumers often lack accurate information about account balances. Sometimes this is a function of consumers not monitoring their accounts carefully, but it can also be a function of transaction processing. For example, many financial institutions will delete a transaction that has not been posted to the account within three days, but will honor the transaction when it is eventually posted. The initial posting, subsequent deletion, and then reposting can mislead a consumer as to the actual account balance and result in the consumer accidentally overdrawing.<sup>14</sup>

The rapid increase in fee levels in recent years, which has occurred without any apparent impact on banks' market share, indicates that overdraft protection is not a competitive market.

Fourth, inadequate disclosure and deliberate manipulation of transaction processing procedures can result in avoidable overdrafts. Consumers lack complete control over the date on which transactions are processed, and, in some cases, over the order in which transactions are initially processed. There is significant variation among financial institutions in the order in which credits and debits are applied to accounts (sometimes with different methods applied for different transaction types), and few institutions disclose to consumers the order in which they process transactions.

Some institutions process transactions in chronological order, while others use other methods, including accumulating batches of transactions that are then processed according to a particular method, such as applying debits before credits or applying debits from largest to smallest. These methods are more likely to result in overdrafts (and in more overdrafts) than other arrangements, such as processing transactions from smallest to largest.

These procedures are often defended on the grounds that consumers would prefer that their big-ticket transactions like mortgage, rent, and car payments be processed, rather than denied for insufficient funds. This argument makes little sense when a financial institution actually honors all the overdrafts; the question in that case is not whether the transactions will be honored, an issue about which consumers' preferences likely vary, but simply how many separate overdraft fees will be charged.

Similarly, the posting date of transactions is not always the same as the transaction date. This can result in consumers miscalculating their available balance and overdrawing. Likewise, signature debit card holds, which occur when a merchant authorizes a transaction before knowing the final transaction amount, can result in overdrafts. Holds are frequently used by gas stations, restaurants, hotels, and car rental companies where the card is authorized before the pump total, tip, or final charges are known. The merchants place a hold on an amount that frequently exceeds the actual authorized transaction amount. The hold may take as long as several days to be removed. As long as it is in place, financial institutions usually treat it as a debit for the full amount of the hold, resulting in a lower account balance and making overdrafts more likely, especially as the consumer does not know the amount or duration of the hold. Thus, a hold can result in an overdraft even if there are in fact sufficient funds.

Finally, there are concerns about the distribution of the cost of overdraft fees. Most overdraft fees are incurred by a limited subset of consumers who repeatedly overdraw. These consumers are generally the poorest stratum of depositors, and the fees are thus the most onerous for them. Many of these consumers also use other

short-term, functionally revolving borrowing products, such as payday loans and credit card cash advances. While these other products have themselves come under significant regulatory scrutiny, they are often cheaper than overdraft loans.

This brief focuses on the institutional side of overdraft. Yet consumer responsibility also plays a role in overdrafts. Many overdrafts are foreseeable and even avoidable, and many depositors manage their accounts such that they rarely or never pay overdraft or other penalty fees.

This research brief examines the potential impact of overdraft regulation on credit unions, but it does not take a position regarding the regulation. Overdraft fees and their regulation comprise an issue that elicits a range of reactions even within the credit union system. In comments from credit unions in response to a Filene Research Institute survey, one respondent noted, “We have never offered a ‘courtesy pay’ program because our board believes that when you find yourself in a hole, it is in your best interest to ‘stop digging!’” Another stated that the “Fed’s opt-in requirement is reasonable and most of the [frequent overdrafters] will opt in.” Other comments, however, noted that “effectively, without this service these members will be forced to payday lenders,” that “members really appreciate this product,” and that “we are in business to serve our membership the best way that we can. We do not need legislation to force us to do the right things.”

## Regulation of Overdraft

Prior to May 2005, the only regulation of overdraft fees was a requirement that they, like all other account fees, be disclosed in account opening disclosures.<sup>15</sup> In 2005, the FRB (for all banks) and NCUA (for all credit unions<sup>16</sup>) passed substantially similar regulations under the Truth in Savings Act to address concerns about the uniformity and adequacy of information provided to consumers about overdrafts.<sup>17</sup> These regulations merely require that institutions that advertise overdraft programs must specifically disclose the total overdraft fees charged monthly and annually on periodic account statements, as well as make certain disclosures in their advertising. Most overdraft programs, however, are not actively advertised within the regulatory definition, and in January 2009, the FRB and NCUA amended the 2005 regulations to apply to all depository institutions, not just those that actively advertise.<sup>18</sup> As a result, information about overdraft fees is now required to be disclosed in two ways: generically in account opening disclosures, accompanied by voluminous other disclosures and typically buried in fine print; and an after-the-fact detailing in account statements of total fees charged. Both of these types of disclosure involve constructive notice to the customer.

However, few consumers read through their account agreements, and many do not look at their account statements.

Recognizing the limitations of the disclosure requirements promulgated in 2005 and January 2009, on November 10, 2009, the FRB enacted an amendment<sup>19</sup> (the overdraft rule) to Regulation E (Reg E)<sup>20</sup> under the Electronic Fund Transfer Act.<sup>21</sup> The overdraft rule applies to all credit unions and banks. The main function of the overdraft rule is to require that consumers affirmatively opt in to discretionary overdraft protection for ATM and POS debit card transactions.<sup>22</sup> The opt-in requirement prohibits financial institutions from charging any overdraft fees for discretionarily honoring ATM or POS debit card transactions if the consumer has not affirmatively opted in to the protection after notice, including disclosure of the fees.

The required fee disclosure must describe the overdraft service, the types of transactions for which an overdraft fee may be imposed,<sup>23</sup> the fees involved,<sup>24</sup> and any limits on those fees.<sup>25</sup> A consumer's consent to the fees does not expire upon opting in,<sup>26</sup> but the account holder has a perpetual right to revoke consent for overdrafts,<sup>27</sup> and consent would have to be obtained again upon any changes to the disclosed terms. For joint accounts, only one account holder need opt in.<sup>28</sup> The overdraft rule also prohibits the tying of overdraft protection on ATM and POS debit transactions with protection on other transactions,<sup>29</sup> and it prohibits discrimination in account terms against customers who do not opt in to the protection.<sup>30</sup> The overdraft rule goes into effect for new accounts on July 1, 2010,<sup>31</sup> and for existing accounts as of August 15, 2010.<sup>32</sup>

The opt-in requirement does not apply to check or ACH<sup>33</sup> overdrafts of any sort,<sup>34</sup> nor does it apply to line of credit overdraft service,<sup>35</sup> linked account overdraft service,<sup>36</sup> margin account overdrafts,<sup>37</sup> or decoupled debit cards.<sup>38</sup> The reason for the check and ACH exclusions is that the growth in overdraft fees has been fueled by debit and ATM transactions, many of which involve small-dollar discretionary purchases rather than major recurring expenses like mortgage, rent, car loan, credit card, and utility payments. Moreover, when POS debit or ATM transactions are denied, the consumer learns in real time and is thus able to avoid bounce fees from merchants. Decoupled debit cards are issued by one financial institution and linked with an account at another institution. Decoupled debit transfers are processed as ACH transactions and thus fall under the ACH exclusion, while linked account and margin account overdrafts are subject to other regulatory regimes (TILA/Reg Z and Regulation T/NASD Rule 2520).

In addition to the overdraft rule, legislation has been proposed in Congress that would enact farther-reaching regulation of overdrafts.

Senate bill 1799, the Fairness and Accountability in Receiving Overdraft Coverage Act of 2009 (the “FAIR Overdraft Coverage Act”) and the nearly identical House bill 3904, the Overdraft Protection Action of 2009 (together the overdraft bills), would also require consumer opt-ins for all overdraft coverage, not just debit and ATM overdrafts.<sup>39</sup> These bills would also limit the number of overdraft fees that could be levied per month and per year, limit fees to a reasonable and proportional amount, prohibit overdraft fees resulting from debit transaction holds if the hold was for more than the actual transaction amount, require same-day notification of overdraft fees to consumers, require that transactions be posted to accounts in a manner that does not incur avoidable overdrafts, and prohibit NSF fees for debit and ATM transactions.<sup>40</sup> Whether either bill will become law remains uncertain.

## Credit Unions and Overdraft: A Statistical Picture

Overdraft protection programs have been studied before, but the most recent study focusing on credit unions is from 2005<sup>41</sup> and was not undertaken with an eye to the impact of the overdraft regulation. To this end, the Filene Research Institute administered to credit unions an anonymous survey on overdraft practices. One hundred eighty-five credit unions responded to the survey, although not all responded to every question. The chief findings are summarized below, and additional findings are encapsulated in data tables at the end of the research brief.

### Survey Respondents

A wide range of credit unions is represented in the survey. Approximately half of the respondents are federally chartered.<sup>42</sup> Almost all respondents are federally insured.<sup>43</sup> Two-thirds of respondent credit unions have at least \$100M in total assets. The median (mean) membership of respondents is 36,650 (61,273) and ranges from 1,070 to 492,000. The limited number of credit unions that responded to the survey, as well as the nature of the survey, counsels caution in interpreting the results, which are generally not weighted for asset or membership size.

Moreover, it is important to emphasize that there is significant variation in overdraft programs among credit unions, particularly in fee structures and overdraft limits. Credit union business models also vary. While most credit unions have a deposit-taking model, some low- to moderate-income credit unions are primarily in the business of providing transaction services. Therefore, it is difficult to project the ultimate impact of regulatory changes on credit unions. There will undoubtedly be some credit unions that are more severely

affected than others. Nonetheless, some clear trends emerge from the survey respondents.

### Overdraft Fees and the Credit Union Business Model

Fee income is an important part of the typical credit union business model. The Credit Union National Association (CUNA) reports that between 2005 and 2009, fee income averaged around 12%–13% of credit union gross revenue and vastly exceeded net income (return on assets).<sup>44</sup> Survey respondents report a similar role for fee revenue. Respondents derive a median (mean) 17.2% (18.7%) of gross revenue from fees.

Most credit unions permit some form of overdrafting. The vast majority (81.5%) have automated overdraft programs in which only qualified overdrafts are honored, as determined by standardized procedures. A similar percentage (79.2%) offer linked-account overdraft protection, in which all overdrafts on the transaction account are covered up to the amount in linked accounts, or overdraft lines of credit (77.4%), in which all overdrafts up to the amount of the line are honored. A small minority (13.1%) give permission to overdraw on an informal, ad hoc basis.

Between 2005 and 2009, fee income averaged around 12% to 13% of credit union gross revenue and vastly exceeded net income (return on assets).

Overdraft fees are a major component of fee income. The median (mean) percentage of respondents' fee income from overdraft is 39.5% (40%). This finding is consistent with a previous finding in 2005 that 40% of credit union fee income comes from overdraft fees.<sup>45</sup> This means that overdraft fees account for approximately 6%–7% of credit union gross revenue.

Although overdraft fees are a major component of credit union fee income, only a small percentage of credit union members overdraw in 2009. The median (mean) percentage of members overdrawing at some point in the year is 13.58% (16.87%). Some credit unions are outliers in this regard, however, and report that between a third and three-quarters of their members overdraw in 2009. Accordingly, the

*Figure 1: Overdraft Programs Offered*

Overdraft program type	Percentage of responses	Number of responses
Automated overdraft	81.5	137
Linked-account overdraft	79.2	133
Overdraft line of credit	77.4	130
Informal overdraft permission	13.1	22

*Figure 2: Overdraft Fees and Usage (Data Are for 2009)*

	Median	Mean	Standard deviation	Number of respondents
Percentage of gross revenue from fees	17.2	18.69	11.84	158
Percentage of fee income from overdraft	39.5	40.48	24.85	157
Percentage of members who overdrew	13.58	16.87	13.45	109
Percentage of members who overdrew multiple times	11	19.13	22.75	93
Mean number of times members overdrew	2.2	4.02	4.42	65
Median number of times members overdrew	0	2.73	4.99	60
Mean number of times overdrafters overdrew	9	16.46	37.77	69
Median number of times overdrafters overdrew	4	11.21	20.05	67
Percentage of members who overdrew exactly 2 times	2	5.1	9.14	74
Percentage of members who overdrew exactly 3 times	1.4	4.09	8.44	73
Percentage of members who overdrew exactly 4 times	1	3.96	9.37	73
Percentage of members who overdrew exactly 5 times	0.8	3.31	7.09	73
Percentage of members who overdrew 6–10 times	2.34	4.78	7.27	73
Percentage of members who overdrew more than 10 times	3.2	7.09	10.22	73
Overdraft usage fee	\$25	\$25.84	\$5.94	159
Amount paid in overdraft fees (average of all members)	\$60	\$89.15	\$115.24	90
Amount paid in overdraft fees (average of overdrafters only)	\$238.25	\$263.28	\$169.59	67
Importance of overdraft to your credit union's profitability on scale of 1–10 (10=highest)	8	7.76	5.28	165

median (mean) of the median number of times members overdrew was 0 (2.73). When the median (mean) of the mean number of times members overdrew is examined, it is slightly higher: 2.2 (4.02).

For those credit union members who do overdraft, however, overdrafts are quite common. Thus, the median (mean) percentage of members with multiple overdrafts is 11% (19.13%).<sup>46</sup> The median (mean) percentage of members who overdrew 2 times is 2% (5.1%), 3 times is 1.4% (4.09%), 4 times is 1% (3.96%), 5 times is 0.8% (3.31%), 6–10 times is 2.34% (4.78%), and more than 10 times is 3.2% (7.09%).

The median (mean) overdraft fee charged is \$25 (\$25.84) per overdraft, although some credit unions charge as high as \$35, and a handful of credit unions have tiered overdraft fee schedules. Almost all respondents (97.5%) charge their overdraft fee on a per-item, rather than a per-day, basis. Likewise, almost all respondents (93.1%) only charge a usage fee for overdrafts, with no additional maintenance or initiation fees.

The median (mean) credit union member paid \$60 (\$89.15) in overdraft fees in 2009. Of those who paid fees, however, the median (mean) is \$238.25 (\$263.28). Not all credit union members have

checking accounts, however, so these figures are higher if only those members with checking accounts are considered.

Overdrafts are spread out evenly among paper checks and ACH and POS debit transactions, each accounting for roughly a third of overdrafts, with ATM overdraft withdrawals being negligible at most institutions. There was, however, significant variation among individual institutions; some had most of their overdraft from paper checks, while others were primarily debit overdrafts. Low ATM overdraft numbers may be a function of many credit unions having few of their own ATMs. The distribution of overdrafts by transaction type may reflect the products and services offered by particular institutions. It may also reflect that, at least historically, credit unions processed a disproportionately large percentage of checks relative to their deposit base<sup>47</sup> and had a higher check return rate than either savings institutions or commercial banks.<sup>48</sup>

The survey indicates that credit unions receive a smaller percentage of their overdrafts from POS debit and ATM transactions (33%) than do banks (41%).

*Figure 3: Distribution of Overdraft Transactions by Type*

Transaction type	Median	Mean	Standard deviation	Number of responses
Paper checks	32.45	37.16	19.55	122
ACH	25	26.15	14.09	121
POS debit	34	32.25	21.95	121
ATM	0	5.02	9.37	118

Caution should be used, however, in extrapolating current figures from these historical numbers, as debit card and ACH transactions have increasingly replaced consumer check usage. Nonetheless, the survey indicates that credit unions receive a smaller percentage of their overdrafts from POS debit and ATM transactions (33%) than do banks (41%).<sup>49</sup>

Of the respondents who offer automated overdraft programs (80%), most have it as a default account feature. While most respondents inform members of the service, nearly a fifth (18.3%) do not inform their members. Only 14.8% require their members to opt in to the protection. For those who require members to opt out, around

*Figure 4: Automated Overdraft Program Features*

	Percentage of respondents answering in the affirmative	Number of respondents (total responses = 142)
Members informed of automated overdraft	81.7	116
Opt-in required	14.8	21
Opt-out permitted	86.6	123
Members notified of opt-out possibility on account opening	64.1	91

two-thirds (64.1%) inform members of the opt-out possibility when the account is opened.

Half of respondents process transactions chronologically, in order of presentation; 28.9% process them by size from smallest to largest; and 16.3% process them by size from largest to smallest. This contrasts with banks, where 7.6% process chronologically, 47.2% process from smallest to largest, 24.7% process from largest to smallest, and 18.2% process by check number.<sup>50</sup>

Relatively few respondents (18.3%) outsource their overdraft program. In a previous study of credit union overdraft programs, 44% of respondents outsourced their program.<sup>51</sup> The discrepancy might reflect the self-selection of respondents; credit unions that outsource their overdraft program are less likely to be familiar with the details of their overdraft operations. Both surveys, however, show that credit unions are less likely than banks (54%) to outsource their overdraft programs.<sup>52</sup>

### Overdraft Alternative Products and Credit Unions

Overdraft arguably competes with a number of other financial products, including credit cards (particularly credit card cash advances) and payday loans. All of these products provide consumers with small, short-term loans. Some credit unions offer their members credit cards and/or payday loan products. Overdraft fees are much more central to the credit union business model than either credit cards or payday loans.

*Figure 5: Credit Card Penetration of Members by Credit Union Size, Q1 2009*



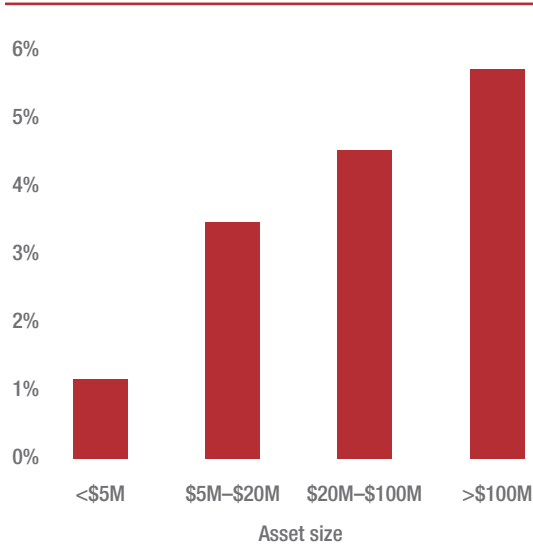
Source: CUNA, U.S. Credit Union Profile, May 28, 2009.

### Credit Cards

Nationally, about half of credit unions (51%) offer credit cards.<sup>53</sup> The number is somewhat higher for respondent institutions, nearly 80% of which offer credit cards. Product penetration among members is quite low for respondents: only 13.6% of members carry a card from their credit union. Nationally, the average penetration rate is similar: 14.3%<sup>54</sup> (see Figure 5). Nationally, card receivables are 5.8% of credit union loan portfolios<sup>55</sup> (see Figure 6). For respondent institutions offering credit cards, cards represent around 8% of credit union gross revenue, indicating that on average credit cards represent only about 6.4% of gross revenue for respondents.

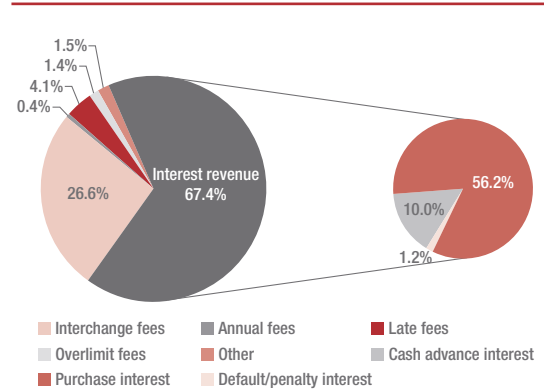
While credit cards in general are a substitute product for overdraft, credit card overlimit fees and cash advances are a particularly close substitute for debit and ATM overdrafts. Only a small fraction of

*Figure 6: Credit Card Percentage of Loan Portfolio by Credit Union Size, March 2009*



Source: CUNA, U.S. Credit Union Profile, May 28, 2009.

*Figure 7: Credit Union Mean Credit Card Revenue by Source*



credit union credit card revenue comes from overlimit fees or cash advances, however. As Figure 7 shows, overlimit fees account for just over 1% of card revenue, while interest on cash advances accounts for 10% of card revenue. Together, they represent only about 0.7% of respondents' gross revenue from all sources.

### *Payday Loans*

A similar picture appears for payday loans. Payday loans are short-term, unsecured extensions of credit, made on the strength of proof of employment (and often with the borrower providing the lender a direct debit authorization or a backdated check for the amount of the loan, interest, and fees). Payday loans generally feature effective APRs of several hundred percent, and many borrowers roll over the short-term loans (for a fee).<sup>56</sup> Typically, payday lending is a storefront (or, increasingly, online) operation.

Several states ban or effectively prohibit traditional payday lending, and federal law caps the APR on payday loans to military personnel at 36%.<sup>57</sup> Traditional payday lending is generally not feasible for federal credit unions because of the statutory interest rate cap of 18% effective APR.<sup>58</sup> State credit unions, however, are sometimes able to offer traditional triple-digit APR payday loans.<sup>59</sup> Credit union service organizations (CUSOs), which are not subject to the interest cap, also sometimes make traditional payday loans, but these are not a

preapproved CUSO activity,<sup>60</sup> so a federal credit union would have to divest from a CUSO that does payday lending.<sup>61</sup>

Given the regulatory framework, it is not surprising that only 16% of respondents offer a payday loan product. For those respondents offering payday loan products, most do not bear the characteristics of traditional payday loans. The median (mean) effective APR on the products is 18% (40.36%). Use is also quite low. The median (mean) percentage of members using the credit union's products is 0.5% (1.13%). The median (mean) percentage of users who roll over is 0% (21.66%), with several credit unions noting that they do not permit rollovers. Not surprisingly, even for these credit unions, payday lending is a miniscule part of their gross revenue, with a median (mean) of 0% (0.5%). For most credit unions, payday lending is a very minor line of business, and credit union payday lending, especially

by federal credit unions, is often quite different from traditional payday lending.

The relative importance of overdraft to other products is reflected in survey responses.

Survey respondents were asked how important they consider overdraft fee income to their credit union's profitability. Responses were on a scale of 1–10, 10 being the highest. The median (mean) response was an 8 (7.76). This contrasts with a median (mean) of 7 (6.48) for credit card income.

On a scale of 1–10, respondents rate overdraft fee income 7.76 and credit card income 6.48 in importance for their credit union's profitability.

## Implications of Overdraft Regulation for Credit Unions

The overdraft rule and the overdraft bills would have very different impacts on credit unions. The overdraft rule's main operational requirement is consumer opt-in for POS debit and ATM overdraft fees. When compared to the overdraft bills, the most notable thing about the overdraft rule is not what it requires, but what it does not. The overdraft rule does not apply to check and ACH overdrafts. It does not restrict overdraft fees, either in quantity or amount, once there is an opt-in. It does not require financial institutions to disclose the order in which they post transactions or to provide timely notice of fees. It does not require financial institutions to post transactions in a particular order. And it does not address debit transaction holds or NSF fees. As discussed below, the different scope of the overdraft rule and the overdraft bills imply very different impacts on credit unions.

### Impact of the Overdraft Rule

The impact of the overdraft rule’s opt-in requirement on credit unions will largely depend on the opt-in rate that credit unions achieve, and, in particular, the opt-in rate for the subset of members who generate most overdrafts. It is possible, however, to get a sense of the outer boundary of the rule’s potential impact.

As Figure 8 shows, credit unions have become increasingly dependent on fee income. The percentage of credit union return on assets (ROA) that is from fees (as distinct from net interest margin and other revenue) has grown steadily since 1989.

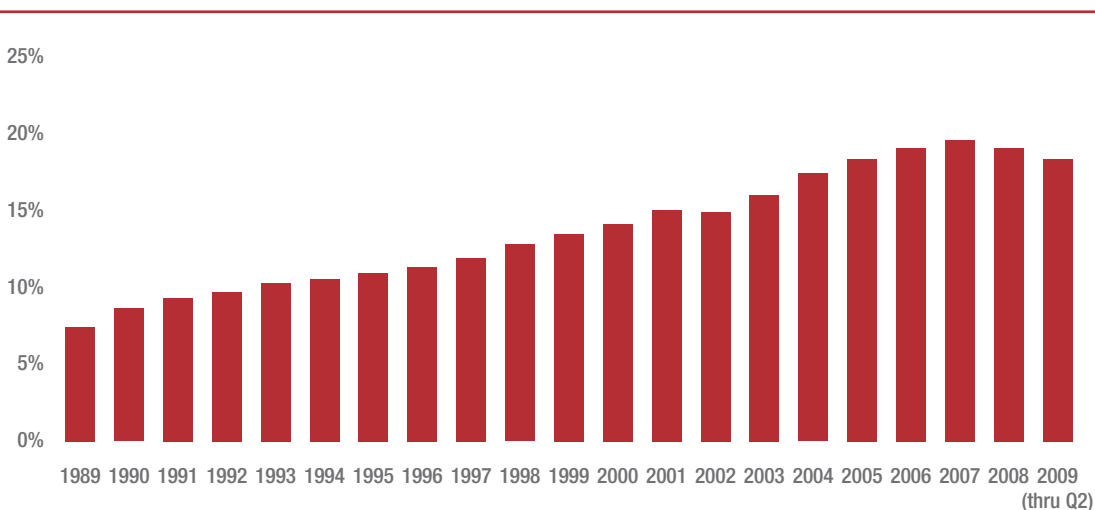
From the survey data, overdraft income represents, on average, around 40% of credit union fee revenue. Approximately a third of this revenue is from POS debit/ATM overdrafts. And approximately 85% of credit unions do not currently require members to opt in to overdraft

The overdraft rule may reduce fee income by as much as 11%.

protection. Accordingly, assuming, in a worst-case scenario, that no members who do not currently opt in would opt in, we can posit a reduction in fee income by 11%.<sup>62</sup>

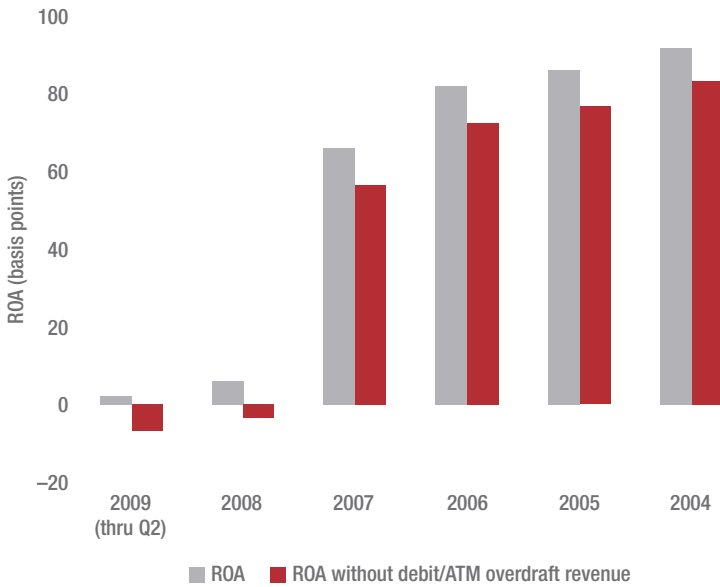
Figure 9 shows how an 11% reduction in fee income would affect credit unions’ ROA. From 2004–2009Q2, the loss of all overdraft revenue from debit and ATM transactions would have had an impact of around 9 basis points (bps) on credit union ROA. What this means is that in the worst-case scenario, loss of debit and ATM overdraft fees would reduce credit union profitability but not destroy

*Figure 8: Percentage of Credit Union ROA from Fees*



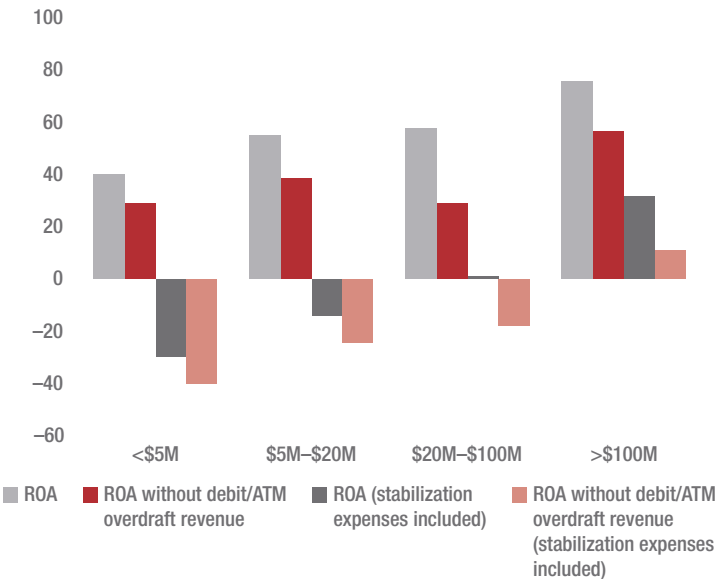
Sources: CUNA, Credit Union Report, Mid-Year 2009; Filene Overdraft Survey Questions 1, 2, and 5; author’s calculations.

**Figure 9: Impact of Loss of Debit/ATM Overdraft Fees on Credit Union ROA, 2004–2009Q2**



Sources: CUNA, Credit Union Report, Mid-Year 2009; Filene Overdraft Survey Questions 1, 2, and 5; author's calculations.

**Figure 10: Impact of Loss of Debit/ATM Overdraft Fees on Credit Union ROA by Credit Union Asset Size Group, Q1–Q3 2009**



Sources: CUNA, U.S. Credit Union Profile, May 28, 2009; Filene Overdraft Survey Questions 1, 2, and 5; author's calculations.

the business model. To be sure, some credit unions are much more dependent on debit/ATM overdraft fees, and some credit unions are only marginally profitable. Institutions of either type would be less able to sustain such a reduction in fee income, and some would either have to restructure their business model or would eventually fail.

The reduction in overdraft fee income is likely to affect smaller credit unions more severely than larger ones. Neither the share of revenue from fees nor the share of fee revenue from overdraft correlates with credit unions' size. Similarly, the mix of overdraft transaction types does not correlate with credit union size, dependence on fee revenue, or share of fee revenue from overdrafts. Nonetheless, small credit unions are generally more vulnerable to reductions in overdraft income because they tend to operate with smaller profit margins. As Figure 10 shows, for 2009 (thru Q3), the impact ranged from around 10 bps for the smallest credit unions to around 20 bps for the largest. Smaller credit unions have lower average ROAs, however, so even though the impact in absolute terms might be less, the impact in relative terms is larger. Indeed, for all but the largest credit unions (>\$100M in assets), ROA in 2009 thru Q3 would have been negative if it weren't for debit and ATM overdraft fees.

It is important to emphasize that these impact estimates are the outer boundary of the overdraft rule's effect. It is unlikely that there will be no opt-ins; some credit unions

anticipate that their repeat overdrafters, in particular, will opt in because these members perceive overdraft as a valuable product and a good alternative to payday loans or credit card cash advances. Whether this is actually economically the case is beside the point; if consumers value overdraft, they are likely to opt in, and the critical opt-ins are those repeat overdrafters.

Although the main factor affecting the impact of the overdraft rule on credit unions will be the opt-in rate, particularly the opt-in rate

Some credit unions anticipate that their repeat overdrafters, in particular, will opt in because these members perceive overdraft as a valuable product and a good alternative to payday loans or credit card cash advances.

for repeat overdrafters, the overdraft rule will also impose some regulatory costs on credit unions; specifically, the solicitation of opt-ins will entail costs. Moreover, it is not clear whether resolicitation of opt-ins is necessary following changes in

overdraft programs. If so, the regulatory costs of the overdraft rule will be higher. Presumably, upon any material changes in the terms disclosed to solicit the original opt-ins, some sort of notice, and possibly a resolicitation of opt-ins, will be necessary. That said, the overdraft rule is silent on this point. It also seems to permit broadly crafted disclosures, such as “fees up to” rather than a precise statement of fees, or even the “any time/any reason” term change provisions that have met with disfavor in credit card programs. Broader disclosures could help credit unions avoid resolicitation costs upon future changes to overdraft programs, but they could be viewed in askance by regulators and could limit opt-in rates. Finding a balance will be a challenge for credit unions, and regulatory guidance might best be sought on disclosures and resolicitations.

### Impact of the Overdraft Bills

While the FRB’s overdraft rule is likely to have a slight impact, the proposed overdraft bills could have a much more pronounced impact. First, the overdraft bills would, in their current form, affect all forms of overdraft. Second, they would restrict the level and frequency of overdraft fees by requiring that fees be reasonable, by capping the number of fees in a period, and by requiring that transactions be posted in a way that minimizes fees. The goal of the legislation is to reduce the amount that consumers pay in overdraft fees, rather than to merely ensure greater consumer understanding of overdraft programs and clearer consent to the fees.

While the overdraft bills would not eliminate all overdraft fee revenue, they would likely have a significant impact. Without knowing how the reasonableness of fees would be determined, it is impossible to predict the maximum impact of the bills, but a significant

reduction in overdraft income would threaten the profitability of many financial institutions. A recent study by the Moebs Research Service found that 44.5% of all banks and credit unions have overdraft income greater than net income.<sup>63</sup> While it seems that banks, particularly large banks, might be more dependent on overdraft revenue than credit unions,<sup>64</sup> for at least some credit unions, reduced overdraft revenue would likely wipe out their margin of profitability.

A recent study found that 44.5% of all banks and credit unions have overdraft income greater than net income.

Whether or not the overdraft bills become law, credit unions will have to grapple with the overdraft rule. The impact of the overdraft rule itself is likely to be fairly minimal, but it is not the only change in the regulatory and business environment. There are signs of a potential “perfect storm” threatening the credit union system. Credit unions’ net interest margin on loans has been under pressure given elevated default rates. Credit card issuance and interchange revenue is under regulatory pressure. And natural person credit unions are still adjusting to stabilization expenses in the wake of corporate credit union failures. Combined with these other changes, credit unions may be less well equipped to weather even small reductions in overdraft fee revenue.

### Potential Responses to the Overdraft Rule

The ultimate impact of the overdraft rule (and any future legislation) on credit union overdraft fee revenue is unclear. The overdraft rule will undoubtedly add some transaction costs, but the ultimate impact depends on the opt-in rate, and especially the opt-in rate for repeat overdrafters. There are presently no indications as to what that rate will be. The Credit C.A.R.D. Act requires that consumers opt in if they are to be charged a fee for an overlimit credit card transaction.<sup>65</sup> The opt-in rate for the credit card overlimit opt-in provision, which went into effect in February 2010, will provide some advanced indication about overdraft fee opt-in rates, but some credit card issuers have already dropped overlimit fees rather than deal with opt-in solicitations.<sup>66</sup>

Consumers could be encouraged to opt in to overdraft protection if they were presented with an alternative of similar NSF fees for denied transactions.

Credit unions will, however, be able to control the form and manner in which opt-ins are solicited. This means credit unions will have the opportunity to encourage members to opt in. In particular, the overdraft rule applies only to the payment of overdrafts; it does

not address fees for denial of transactions due to insufficient funds. Thus, consumers could be encouraged to opt in to overdraft protection if they were presented with an alternative of similar NSF fees for denied transactions.

Credit unions will also continue to control the order in which they process transactions. Because the overdraft rule applies only to POS debit and ATM overdrafts, if a credit union posted those transactions first, and then checks and ACH transactions, it would be the checks and ACH transactions, rather than the POS debit and ATM transactions, that caused the overdrafts. Therefore, even if the member had not opted in to overdraft protection on debit and ATM transactions, the credit union could still charge overdraft fees. Such a practice might not be well received by credit union members, but it illustrates that there are transactional responses to the regulatory change that can help offset income reductions, although they may come at the cost of member satisfaction.

Signature debit card transaction holds present a particularly thorny problem for credit unions. If members do not opt in to overdraft protection, then every time a credit union preauthorizes a signature debit card transaction, it risks extending overdraft protection without compensation. This presents both a kiting risk and a cost of funds problem. One solution to this problem is to shift card issuance to PIN debit when possible. Interchange revenue from PIN debit is often lower than on signature debit, however, and there are many locations in which PIN debit is not accepted, including many of the main types of merchants that generate debit holds: restaurants, gas stations, hotels, and car rental companies. Another possible solution is to work with the debit card processing networks (MasterCard and Visa) to either reduce clearing time so that exposure on holds is limited, or to get higher interchange income on transactions that involve holds (basically a hold fee on the merchant).

A third possibility is to charge members a debit card hold fee, regardless of whether there is an overdraft. Such fees could be waived or reimbursed on conditions that do not match with an overdraft *per se*, but still largely compensate the credit union for the cost and risk involved with overdraft extensions. For example, hold fees could be waived provided that members maintain certain average daily balances, overdraft no more than a limited number of times in a month, or do not exceed a certain average daily overdraft amount in a month. There is regulatory risk with attempts to craft offsetting fees, and credit unions would be well advised to seek opinion letter guidance before pursuing such a route.

If overdraft income is reduced in any substantial fashion, there are several possible responses for credit unions.<sup>67</sup> First, credit unions

could reconsider their fee structures for other services, particularly free transaction accounts. Overdraft fees offset the cost of offering free transaction accounts, so charging account fees could compensate for reduced overdraft revenue. Alternatively, credit unions could offer

free checking, but only when it is bundled with another product. In such a case, the checking account would not be truly “free,” but if members perceived the bundled product as valuable, they might gladly accept

One possibility is to adopt the Ryan Air business model and have only the most basic service level be free, with a la carte pricing for any additional services or product features.

the package. A third possibility is to adopt the Ryan Air (a bargain European airline) business model and have only the most basic service level be free, with a la carte pricing for any additional services or product features. And finally, credit unions could simply attempt to live with diminished profit margins.

Credit unions would be ill advised to pursue strategies that eliminate free transaction accounts or attempt to bundle other products with transaction accounts. The strength of credit unions lies in their difference from commercial banks and thrifts. While credit unions need to offer the same general types of consumer financial services to be competitive, they do not need to offer them in the same manner. Quality member service is one of the premium features of credit unions, and it is inconsistent with business models in which members feel they are being nickel-and-dimed.

No credit union wishes to see its ROA diminish, but credit unions’ mutual nature provides them with flexibility—which other financial institutions do not have—in dealing with diminished revenue. Being mutual institutions imposes a disadvantage on credit unions in terms of capital formation, but it is also a benefit, as credit union management is not under pressure to achieve quarterly earnings targets. As mutual institutions, so long as credit unions maintain a sufficiently positive ROA to supply their own capital needs from retained earnings, their precise ROA is immaterial; any ROA above that which is retained is simply returned to members as dividends. Rather than be charged higher rates and fees up front and receive a larger offsetting dividend, most customers would likely prefer to have lower rates and fees.

This suggests that credit unions should attempt to maintain customer-friendly features like free checking and attempt to survive with diminished ROA. Ultimately, this might be the competitively wise move as well. Credit unions have long been leaders in offering free checking,<sup>68</sup> and if commercial banks and thrifts eliminated free checking, the continuation of free checking at credit unions would add greatly to their attractiveness to consumers.

Credit unions might also do well to view repeat overdrafting members as potential long-term clients rather than as an immediate source of fee income. Members who repeatedly overdraw present an outreach opportunity for credit unions: these members may be in financial distress and could benefit from affordable short-term credit

and financial counseling. Offering assistance to these members can be done profitably and presents a method of building member loyalty.

Credit unions have long been leaders in offering free checking, and if commercial banks and thrifts eliminated free checking, the continuation of free checking at credit unions would add greatly to their attractiveness to consumers.

The North Carolina State Employees' Credit Union's

(NCSECU) Salary Advance Loan (SAL) program presents an example. NCSECU's SAL is payday loan, but it is made at a 12% interest rate, a fraction of regular payday lenders' rates. Five percent of every SAL is placed in a restricted access savings account, which is often the first savings account members have had. NCSECU also makes financial counseling available to the members for free. The default rate on the program has been minimal,<sup>69</sup> and it has been NCSECU's most profitable loan product.<sup>70</sup> A SAL saves NCSECU members approximately \$70 compared to a typical payday loan,<sup>71</sup> and the program appears to have generated significant member loyalty.<sup>72</sup> By providing affordable credit and financial counseling to members with frequent short-term credit needs, credit unions can profitably build member loyalty.

A reduction in overdraft revenue will present challenges for all financial institutions. Credit unions' greater ability to retain popular customer services like free checking in the face of diminished ROA could help credit unions grow their membership base. From a market share perspective, credit unions might find a silver lining to overdraft regulation.

*Figure 11: Respondent Descriptive Information*

	Percentage of responses		Number of responses	
Federally chartered	50.6		83	
State chartered	49.4		81	
Federally insured	95.7		157	
Not federally insured	4.3		7	
Total assets <\$5M	2.4		4	
Total assets \$5M–\$20M	11.4		19	
Total assets \$20M–\$100M	18.7		31	
Total assets >\$100M	67.5		112	
	Median	Mean	Standard deviation	Number of responses
Credit union membership size	36,650	61,273.69	78,147.46	164

*Figure 12: Use of Third-Party Vendor for Overdraft Program*

Third-party vendor used?	Percentage of responses	Number of responses
Yes	18.3	30
No	81.7	134

*Figure 13: Transaction Processing Order*

Transaction processing order	Percentage of responses	Number of responses
Chronologically, by order of presentation	50.0	83
By size, smallest to largest	28.9	48
By size, largest to smallest	16.3	27
By check number	4.2	7
Other	0.6	1

*Figure 14: Application of Overdraft Fees*

	Percentage of responses	Number of responses
Overdraft fee charged on a per-item basis	97.5	157
Overdraft fee charged on a per-day basis	2.5	4

*Figure 15: Types of Overdraft Fees*

Overdraft fees other than usage (e.g., maintenance, initiation)?	Percentage of responses	Number of responses
Yes	6.9	11
No	93.1	148

*Figure 16: Credit Union Credit Card Programs*

Credit card offered by credit union?	Percentage of responses	Number of responses
Yes	79.4	131
No	20.6	34

*Figure 17: Credit Union Credit Card Program Details*

	Median	Mean	Standard deviation	Number of responses
Percentage of members with a credit card from your credit union	13.6	13.47	7.09	99
Percentage of gross revenue from credit cards	7.52	8.77	7.20	118
Percentage of card revenue from interest	69.3	67.39	14.51	94
Percentage of card revenue from interchange	24.88	26.55	12.35	94
Percentage of card revenue from annual fees	0	0.37	2.00	76
Percentage of card revenue from late fees	3.67	4.14	3.17	82
Percentage of card revenue from overlimit fees	0.5	1.35	2.63	74
Percentage of card revenue from other sources	0	1.46	5.78	72
Percentage of interest income from cash advance APR	8	15.63	22.8	47
Percentage of interest income from purchase APR	95	87.25	21.99	64
Percentage of interest income from default/penalty APR	0	1.79	5.9	41
Importance of credit card income to your credit union's profitability on scale of 1–10 (10=highest)	7	6.48	2.73	140

*Figure 18: Credit Union Offering of Payday Loan Products*

Payday loan product offered?	Percentage of responses	Number of responses
Yes	16	25
No	84	130

*Figure 19: Features of Payday Lending at Credit Unions*

	Median	Mean	Standard deviation	Number of respondents
Percentage of gross revenue from payday loans	0.075	0.50	0.83	18
Average effective APR on payday loan product	18	40.36	87.23	20
Percentage of members using credit union payday loan product	0.5	1.13	1.94	19
Percentage of members who roll over credit union payday loan product (often not permitted)	0	21.66	37.86	11

1. Carveth Read, *Logic: Deductive and Inductive* (London: Grant Richards, 1898), 272.
2. Eric Halperin and Peter Smith, “Out of Balance,” Center for Responsible Lending, July 11, 2007, [www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf](http://www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf), 9.
3. Saskia Scholtes and Francesco Guerrera, “Banks Make \$38bn from Overdraft Fees,” *Financial Times*, August 9, 2009.
4. Debit card overdraft fees have also spurred significant litigation. See *Checking Account Overdraft Litigation*, MDL 2036 (S.D. Fla. 2009); *Gutierrez v. Wells Fargo & Company*, C-07-5923-WHA (N.D. Cal. 2007).
5. Leslie Parrish, “Overdraft Explosion: Bank Fees for Overdrafts Increase 35% in Two Years,” Center for Responsible Lending, October 6, 2009, 2.
6. FDIC Study of Bank Overdraft Programs, November 2008, v.
7. Saskia Scholtes and Francesco Guerrera, “Banks Make \$38bn from Overdraft Fees,” *Financial Times*, August 9, 2009.
8. 70 Fed. Reg. 29593 (May 24, 2005), codified at 12 C.F.R. § 230.11 (FRB); 70 Fed. Reg. 72898 (Dec. 8, 2005), codified at 12 C.F.R. § 707.11 (NCUA).
9. 74 Fed. Reg. 5593 (Jan. 29, 2009), codified at 12 C.F.R. §§ 230.6, 230.11 (FRB); 74 Fed. Reg. 36104 (July 22, 2009), codified at 12 C.F.R. §§ 707.6, 707.11 (NCUA).
10. 74 Fed. Reg. 59052-53 (Nov. 10, 2010), codified at 12 C.F.R. § 205.17.
11. 15 U.S.C. §§1601 *et seq.*
12. 12 C.F.R. Pt. 226.
13. FDIC Study of Bank Overdraft Programs, November 2008, 56.
14. Order on Motion Challenging Damage Study and Seeking Class Decertification, *Gutierrez v. Wells Fargo & Company*, C-07-5923-WHA (N.D. Cal. 2007), [www.wfblawsuit.com/pd'fs/DecertificationOrder.pdf](http://www.wfblawsuit.com/pd'fs/DecertificationOrder.pdf), 10–12.
15. 12 C.F.R. § 707.4(b)(4) (NCUA); 12 C.F.R. § 230.4(b)(4) (FRB).
16. Exempt from the Truth in Savings Act and from regulations thereunder are nonautomated credit unions that are not required to comply with the requirements of Title II of Act Dec. 19, 1991, P.L. 102–242, 105 Stat. 2286 as of Sept. 30, 1996, pursuant to the determination of NCUA.

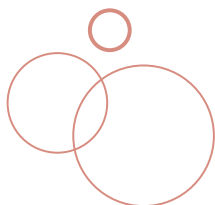
17. 70 Fed. Reg. 29593 (May 24, 2005), codified at 12 C.F.R. § 230.11 (FRB); 70 Fed. Reg. 72898 (Dec. 8, 2005), codified at 12 C.F.R. § 707.11 (NCUA).
18. 74 Fed. Reg. 5593 (Jan. 29, 2009), codified at 12 C.F.R. §§ 230.6, 230.11 (FRB); 74 Fed. Reg. 36104 (July 22, 2009), codified at 12 C.F.R. §§ 707.6, 707.11 (NCUA).
19. 74 Fed. Reg. 59033 *et seq.* (Nov. 10, 2010).
20. 12 C.F.R. Pt. 205.
21. 15 U.S.C. §§ 1693 *et seq.*
22. 74 Fed. Reg. 59052-53 (Nov. 10, 2010).
23. 12 C.F.R. § 205.17(d)(1).
24. 12 C.F.R. § 205.17(d)(2).
25. 12 C.F.R. § 205.17(d)(3).
26. 12 C.F.R. § 205.17(g).
27. 12 C.F.R. § 205.17(f).
28. 12 C.F.R. § 205.17(e).
29. 12 C.F.R. § 205.17(b)(2).
30. 12 C.F.R. § 205.17(b)(3).
31. 12 C.F.R. § 205.17(c)(2).
32. 12 C.F.R. § 205.17(c)(1).
33. Many routinely scheduled payments are ACH transactions, and many checks are converted to ACH for presentment.
34. 12 C.F.R. § 205(b)(1).
35. 12 C.F.R. § 205.17(a)(1).
36. 12 C.F.R. § 205.17(a)(2).
37. 12 C.F.R. § 205.17(a)(3). See also 15 U.S.C. § 1603(2); 12 C.F.R. § 226.3(d).
38. 12 C.F.R. § 205.17(b)(1), Official Staff Commentary, Comment. 17(b)-1.i (“Section 205.17(b) does not apply to ATM and one-time debit card transactions made with a debit card issued by or through a third party unless the debit card is issued on behalf of the account-holding institution”).
39. Fairness and Accountability in Receiving Overdraft Coverage Act of 2009, S. 1799, 111th Cong., § 4; Overdraft Protection Act of 2009, H.R. 3409, 111th Cong., § 4.
40. Fairness and Accountability in Receiving Overdraft Coverage Act of 2009, S. 1799, 111th Cong., § 4; Overdraft Protection Act of 2009, H.R. 3409, 111th Cong., § 4.
41. CUNA Center for Research and Advice, “Checks & Balances: Credit Unions & Overdraft Privilege Programs” (2005).
42. 83 federally chartered; 81 state chartered.

43. 157 insured; 7 not insured.
44. CUNA Credit Union Report, Mid-Year 2009, 9.
45. CUNA Center for Research and Advice, “Checks & Balances: Credit Unions & Overdraft Privilege Programs” (2005), 6.
46. The median (mean) number of median times the overdrafters overdrew was 4% (11.21%), and the median (mean) number of the mean number of times was 9 (16.46).
47. Federal Reserve System, *The 2007 Federal Reserve Payments Study: Noncash Payment Trends in the United States: 2003–2006*, December 10, 2007, 9; FDIC Statistics on Depository Institutions; NCUA; author’s calculations (credit unions processed 8.8% of checks but had only 7.18% of deposits).
48. Geoffrey R. Gerdes and Jack K. Walton II, *The Use of Checks and Other Noncash Payment Instruments in the United States*, 88 Fed. Reserve Bull. 360, 363 Table 4 (August 2002).
49. FDIC Study of Bank Overdraft Programs, November 2008, 78–79.
50. FDIC Study of Bank Overdraft Programs, November 2008, 11, Table III-9.
51. CUNA Center for Research and Advice, “Checks & Balances: Credit Unions & Overdraft Privilege Programs” (2005), 11.
52. FDIC Study of Bank Overdraft Programs, November 2008, 51, Table VII-1.
53. CUNA, U.S. Credit Union Profile, 3d Quarter 2009, December 15, 2009.
54. CUNA, U.S. Credit Union Profile, 3d Quarter 2009, December 15, 2009.
55. CUNA, U.S. Credit Union Profile, 3d Quarter 2009, December 15, 2009.
56. Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate Caps Are Only Proven Payday Lending Reform*, Center for Responsible Lending, Dec. 13, 2007, 5 (citing average payday loan as carrying a 400% effective APR).
57. 10 U.S.C. § 987.
58. 12 U.S.C. § 1757(5)(A)(vi) (15% limit, with permission for NCUA to raise temporarily). The NCUA has raised the limit to 18% continuously since 1987. Statement of the Honorable Joann M. Johnson, Chairman, National Credit Union Administration, “Regulation Z and Credit Card Disclosure Revisions” before the Subcommittee on Financial Institutions and Consumer Credit, U.S. House of Representatives, June 7, 2007, 14. The cap has been interpreted as applying to the effective interest rate, rather than the stated interest rate. *Id.*

at 14; 12 C.F.R. § 701.21(b)(7); NCUA Letter 09-FCU-05 (July 2009); NCUA OGC Opinion Letter 00-1217, Jan. 25, 2001 (noting that “NCUA has generally looked to the Federal Reserve System’s Regulation Z, implementing the Truth in Lending Act, for guidance on what constitutes a finance charge. 12 C.F.R. § 226; 15 U.S.C. § 1605. Transaction fees are specifically included among the examples of finance charges in Regulation Z. 12 C.F.R. § 226.4(b)(2).”)]; NCUA OGC Opinion Letter Nos. 91–0412 (late charges are not considered a finance charge by NCUA for usury cap purposes). It is unclear if this opinion letter would still hold after the Supreme Court’s ruling in *Smiley v. Citibank*, 517 U.S. 735 (1996), which held that late fees were reasonably included in the definition of interest in the regulations of the Office of the Comptroller of the Currency. See also NCUA Letter 09-FCU-05, July 2009, [www.ncua.gov/Resources/09-FCU-05.pdf](http://www.ncua.gov/Resources/09-FCU-05.pdf).

59. National Consumer Law Center, press release, “NCUA Letter Highlights Dangers of False Credit Union Payday Loan ‘Alternatives,’” July 30, 2009, [www.consumerlaw.org/issues/payday\\_loans/content/NCUA-Statement0709.pdf](http://www.consumerlaw.org/issues/payday_loans/content/NCUA-Statement0709.pdf).
60. 12 C.F.R. § 712.
61. NCUA Letter 09-FCU-05, July 2009, [www.ncua.gov/Resources/09-FCU-05.pdf](http://www.ncua.gov/Resources/09-FCU-05.pdf).
62.  $40\% \times 33\% \times 85\% = 11\%$ .
63. Moebs Services, press release, “Consumer Overdraft Fees Increase During Recession,” July 15, 2009, [www.moebs.com/AboutUs/Pressreleases/tabid/58/ctl/Details/mid/380/ItemID/65/Default.aspx](http://www.moebs.com/AboutUs/Pressreleases/tabid/58/ctl/Details/mid/380/ItemID/65/Default.aspx).
64. See Government Accountability Office, “Bank Fees: Federal Banking Regulators Could Better Ensure That Consumers Have Required Disclosure Documents Prior to Opening Checking or Savings Accounts,” [www.gao.gov/new.items/d08281.pdf](http://www.gao.gov/new.items/d08281.pdf), 16 (noting higher fees at larger institutions).
65. 15 U.S.C. § 1637(k).
66. Maria Aspan, “Law Hits Home as Cards Opt Out of Overlimit Fees,” *American Banker*, August 10, 2009, 1 (noting that American Express and Discover are eliminating overlimit fees).
67. Ron Lieber, “Free Checking Could Go the Way of Free Toasters,” *New York Times*, January 23, 2010, B1.
68. CUNA Center for Research and Advice, “Checks & Balances: Credit Unions & Overdraft Privilege Programs” (2005), 2.
69. Pauline Vu, “Credit Unions Help Strapped State Employees,” Stateline.org, [www.stateline.org/live/details/story?contentId=423101](http://www.stateline.org/live/details/story?contentId=423101).

70. Credit Builders Alliance, “North Carolina State Employees Credit Union,” [www.creditbuildersalliance.org/toolkit-innovations/ncsecu.html](http://www.creditbuildersalliance.org/toolkit-innovations/ncsecu.html).
71. Credit Builders Alliance, “North Carolina State Employees Credit Union,” [www.creditbuildersalliance.org/toolkit-innovations/ncsecu.html](http://www.creditbuildersalliance.org/toolkit-innovations/ncsecu.html).
72. Pauline Vu, “Credit Unions Help Strapped State Employees,” Stateline.org, [www.stateline.org/live/details/story?contentId=423101](http://www.stateline.org/live/details/story?contentId=423101).



**ideas grow here**

PO Box 2998  
Madison, WI 53701-2998  
Phone (608) 231-8550

**[www.filene.org](http://www.filene.org)**

PUBLICATION #211 (4/10)

ISBN 978-1-932795-90-5

**filene**  
RESEARCH INSTITUTE

