BankThink A World Without Overdraft Protection (It Ain't Pretty)

By *Lynn A. David*

The Consumer Financial Protection Bureau is expected to render a decision soon on how much and how frequently banks can charge customers for overdraft protection. But has the bureau considered the full consequences of a rule that could lead to banks reducing or removing overdraft protection entirely?

If the CFPB issues an unreasonable mandate for banks on overdraft fees, then the banking industry as a whole should stand up to the bureau by removing the service for overdrafts on consumer check and ACH debit transactions. The effect of such an action would be immediate. Consumers would be charged an insufficient funds – known as NSF – fee by both the bank and by merchants unable to process the transaction.

Such a step by banks should exclude overdrafts from ATM transactions and non-recurring point-of-sale debit card transactions. Those types of overdrafts should still receive protection as along as consumers have opted in to the service, as mandated by the Federal Reserve.

But a concerted effort to pull back on overdraft protection would help illustrate just how useful and important a service it is when a bank pays a consumer's obligation, in some cases without being paid back, and would also shine a spotlight for once on the businesses that can charge a fee for insufficient funds. Several months ago, the CFPB issued a report, "Data Point: Checking Account Overdraft", showing that banks usually pay over 80% of overdrawn items, meaning businesses relatively speaking don't charge NSF fees very often.

But if businesses had to charge more NSF fees as a result of there being less overdraft protection, would the CFPB begin to investigate businesses charging those fees to consumers?

The CFPB is only looking at part of the issue when they consider a ruling on overdraft fees. They are not taking into consideration that, on a daily basis, banks throughout the United States are providing overdraft protection for consumer's mortgage and rent payments, food purchases, medical needs, insurance payments, etc. Unfortunately, some customers do not repay the bank and the financial institution takes a loss on the negative checking account balance after the account has been overdrawn 45 to 60 days.

All banks charge off thousands of dollars – for large banks, its millions of dollars – a year from losses on checks, ACH, ATM and debit card transactions that were paid for customers but never reimbursed by customers making deposits into their account. In addition, banks must devote employee time and expenses to attempt to collect the charged-off account balances.

The CFPB should reflect on consumers' reaction in 2002 when a three-judge panel for the Ninth Circuit Court of Appeals ruled in a case involving Washington Mutual Bank that "the bank was prevented from recovering overdrafts from (social security) benefits directly deposited in the account." Some banks then discontinued permitting overdrafts on checking accounts with a social security direct deposit. There was so much upheaval from social security recipients who needed the ability to overdraw their accounts that later that year the Social Security Administration filed a brief asking the court to reconsider the decision. It was subsequently reversed.

The CFPB should be prepared for a similar response from consumer groups if an overly aggressive overdraft rule endangers overdraft protection services.

Banks are a significant stabilizing factor in our economy as a result of their payment processing services. The safest action by the CFPB therefore is to take no future action on the overdraft issue.