CALIFORNIA BANKERS ASSOCIATION

STATE ISSUE BRIEF

Overdraft Fees

Highlights

- ***Consumers value overdraft protection and are willing to pay a fee for the service.***
- ***Accountholders must opt-in to overdraft protection and fees are fully disclosed.***
- ***Overdraft fees help cover the cost of offering the service.***
- ***Overdraft fees help increase financial inclusion by helping financial institutions offset the cost of offering zero-balance checking accounts.***

Overdraft protection continues to be extremely popular with customers because it is a vital tool in helping them manage their finances. This service provides a short-term solution for accountholders to help ensure timely payments are made on their financial obligations, such as rent, utilities or auto loans.

Accountholders Must Opt-In to Overdraft Protection

Banks disclose their overdraft protection fees in their account agreement. Additionally, the Federal Reserve formalized a rule in 2009 that amends Regulation E, 12 C.F.R. Part 205 to address overdraft protection programs. The rule generally prohibits financial institutions from assessing fees for paying ATM and one-time debit card transactions that overdraw customer accounts unless the customer affirmatively consents, or opts in, to the overdraft protection program. Accountholders may opt-out at any time to avoid overdraft fees.

Accountholder's Value Overdraft Protection

According to a survey conducted by the American Bankers Association, "88 percent of consumers find their bank's overdraft protection valuable, and 77 percent who paid an overdraft fee were glad their bank covered their payment, rather than returning or declining it. When banks pay the overdraft rather than return an item, consumers also avoid the fee imposed by the payment recipient."

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Overdraft Fees Help Cover the Cost of Protection

Overdraft fees compensate financial institutions for the risk they take by allowing customers to spend money they don't have. If a customer decides to abandon their account entirely and make no further deposits into the account, the bank typically absorbs the loss. According to the most recently available data published by the FDIC, the average loss per abandoned account closure is $310, with such losses accounting for 12.6 percent of total loan losses at financial institutions. Overdraft fees also help banks cover the cost associated with offering free checking accounts. Many banks participate in the Bank On program, designed to provide fee-free or low-fee checking accounts. These accounts are expensive to maintain, and according to the American Banker, overdraft fees cover 30 percent of the overall costs of offering free checking services. Finally, overdraft fees help encourage customers to better manage their checking account, by encouraging financially responsible behavior.

Capping Overdraft Fees Harms Financial Inclusion

A study by the Federal Reserve Bank of New York, published in 2021 and revised in 2023, titled *Who Pays the Price? Overdraft Fee Ceilings and the Unbanked,* concluded that allowing banks to charge overdraft fees directly influenced the ability of banks to eliminate minimum balance requirements which increased financial inclusion. The Federal Reserve Bank of New York Found that in “studying an event in which caps were relaxed, we find banks raised overdraft fees but also expanded overdraft coverage and deposit supply, leading more low-income households to open accounts. While inattentive depositors may not benefit from being banked, the rise in account ownership persists, suggesting newly banked households valued their account even after learning about its costs. We find no evidence that being banked weakens households’ broader credit health, including delinquency, indebtedness, and credit scores. We conclude that overdraft fee caps hamper, rather than foster, financial inclusion.”

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