

MEMO

To: Interested Negotiators
From: Leslie Parrish and Maura Dundon, Center for Responsible Lending
RE: Overdraft fees charged to debit cards
Date: March 4, 2014

We have been following the Department of Education's current negotiated rulemaking session with a particular interest in topics impacting Parent PLUS loans and financial aid disbursements to debit cards.

One issue related to debit cards that was not discussed in the first round of meetings is the charging of high overdraft fees on debit card transactions -- which could otherwise simply be declined at no charge. These fees are possible on either prepaid debit cards or traditional debit cards tied to bank accounts.

The Department should prohibit debit card overdraft fees on accounts or prepaid cards that are marketed to students as part of college-financial institution partnerships and onto which financial aid is disbursed. There is precedent in removing overdraft coverage from debit cards linked to bank accounts and pre-paid debit cards, as this is some large banks' standard practice.¹ There is also precedent for prohibiting overdraft credit and its associated fees from cards onto which federally issued or subsidized funds are disbursed: the Department of the Treasury prohibits high-cost payday loans made through prepaid cards onto which Social Security and other exempt benefits are distributed.²

Overdraft fees are commonly charged as a fixed fee regardless of how much credit is extended, which can result in a very high cost of credit on debit card transactions, which are often for relatively small amounts. For example, banks have been found to charge up to \$36 per overdraft on campus checking accounts,³ and our research has found that consumers pay an average \$1.75 in fees for every \$1 borrowed using a debit card.

A recent analysis conducted by the Consumer Financial Protection Bureau suggests that overdraft fees on debit card and ATM transactions costs consumers who have this feature on their account nearly \$700 per year.⁴ Because young adults swipe debit cards frequently, overdraft fees can quickly multiply and result in hundreds of dollars in debt. A 2008 study by the FDIC found that young adults incurred more overdraft fees, and were more likely, to do so by using a debit card, than account holders in other age groups.⁵

Overdraft fees are inconsistent with several elements of the Department of Education's existing rules on cards or accounts onto which financial aid is disbursed. As outlined by US PIRG in a 2012 report on student debit cards, schools (and

financial institutions who handle refunds on the school's behalf) cannot market a card/account as credit or convert it to a credit instrument.⁶ Overdraft coverage is a form of credit, since the financial institution covers the consumer's shortfall and subsequently is repaid the amount extended plus a fee. In addition, a financial institution is barred from making any claims against the financial aid funds loaded on a card or deposited into an account without the student's express permission.⁷ This may conflict with the common practice of automatically extending overdraft credit and repaying it and the associated fee from the next incoming deposit.

Recognizing the damage debit card-triggered overdraft fees can cause, federal financial regulators now require banks to get consumer consent before extending overdraft coverage on debit card transactions for a fee.⁸ While this is a step in the right direction, banks have a strong incentive to aggressively market overdraft coverage. Young adults, who are often opening their first accounts and have limited banking experience, are among the most vulnerable.

More information on the overdraft issue is available in the attached report (link: <http://www.responsiblelending.org/state-of-lending/reports/8-Overdrafts.pdf>)

¹ For example, HSBC and Citibank do not charge overdraft fees on either debit card or ATM transactions, Chase does not charge overdraft fees on ATM withdrawals, and Bank of America does not charge overdraft fees on debit card transactions. See Rebecca Borne and Peter Smith, *The State of Lending in America & its Impact on U.S. Households: High-Cost Overdraft Practices*, Center for Responsible Lending (July 2013), available at <http://www.responsiblelending.org/state-of-lending/reports/8-Overdrafts.pdf>.

² National Consumer Law Center, *Prepaid Debit Cards for Social Security and SSI Benefits*, available at http://www.nclc.org/images/pdf/older_consumers/cc_prepaid_debit_cards.pdf.

³ Government Accountability Office, *College Debit Cards: Actions Needed to Address ATM Access, Student Choice, and Transparency* (February 2014), available at <http://www.gao.gov/assets/670/660919.pdf>.

⁴ Consumer Financial Protection Bureau, *CFPB Study of Overdraft Programs: A White Paper of Initial Data Findings* (June 2013), available at http://files.consumerfinance.gov/f/201306_cfpb_whitepaper_overdraft-practices.pdf.

⁵ Federal Deposit Insurance Corporation, *FDIC Study of Bank Overdraft Programs* (November 2008), available at http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf.

⁶ Rich Williams and Edmund Mierzwinski, *The Campus Debit Card Trap: Are Bank Partnerships Fair to Students?* (May 2012), available at http://www.uspirg.org/sites/pirg/files/reports/thecampusdebitcardtrap_may2012_uspef.pdf.

⁷ Ibid.

⁸ Federal Reserve Board, *Electronic Funds Transfers Final Rule, Regulation E*, 74 Fed. Reg. 59033, 59041 (2009).