



Overdraft Explosion:

Bank fees for overdrafts increase 35% in two years

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TABLE OF CONTENTS

Overview 2

Findings 3

Discussion 7

Conclusion & Policy Recommendations 9

Notes 11

Summary Findings:

- Finding 1:** Over 50 million Americans overdrew their checking account at least once over a 12-month period, with 27 million accountholders incurring five or more overdraft or non-sufficient funds (NSF) fees.
- Finding 2:** Banks and credit unions collected nearly \$24 billion in overdraft fees in 2008.
- Finding 3:** Overdraft fee income for banks and credit unions rose 35 percent from 2006 to 2008.

OVERVIEW

It is now standard practice for most banks and credit unions to automatically enroll checking account customers in their most expensive overdraft loan program—one in which the financial institution generally approves transactions when the accountholder does not have enough funds to cover them, in return for a fee of around \$34 per overdraft.

Banks contend that this type of overdraft protection is a service to their customers, helping them to avoid bouncing checks. They further claim that the alternative would be to return the check unpaid, with the customer incurring an NSF fee from the bank and, potentially, a bad check fee from a merchant or a late fee from a landlord or utility company.

However, the reality is far different than the scenario painted by banks. Overdraft fees are most typically triggered not by checks, but by debit card transactions and ATM withdrawals that could easily be denied for no fee.¹ In addition, common banking practices—such as re-ordering transactions from largest to smallest—increase the number of overdraft fees paid by customers rather than helping them avoid charges.² Institutions also generally place no meaningful limits on how many fees a customer can incur within a given period.³ Finally, because banks generally charge a fixed overdraft fee regardless of the size of the transaction covered, the fee bears no relationship to the actual cost to the institution of covering the overdraft. In fact, previous CRL research found that consumers paid about \$2 in fees for every \$1 in credit extended if they overdrew their account using a debit card at a checkout counter.⁴

These practices are especially alarming given that institutions automatically enroll consumers into this type of program, even when lower-cost forms of overdraft protection—such as a formal overdraft line of credit or a link to a savings account—are usually available. Several CRL surveys have found that an overwhelming majority of respondents, including those who have recently overdrawn their account, want a choice about what—if any—form of overdraft program to enroll in and prefer that debit card overdrafts not be covered.⁵

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This report quantifies the number of Americans that have overdrawn their account and are potentially affected by the abusive practices typical of today’s overdraft loan programs. It also updates previous CRL estimates of the resulting costs incurred by consumers. To this end, we utilize results from a recent FDIC study to estimate the number of Americans whose accounts become overdrawn in a given year, with a focus on those accountholders with five or more incidents per year. In addition, we also update our 2006 estimate of the total cost consumers pay annually in overdraft fees and evaluate the dramatic increase in fees over a two-year period.

FINDINGS

Finding 1: Over 50 million Americans overdrew their checking account at least once over a 12-month period, with 27 million accountholders incurring five or more overdraft or non-sufficient funds (NSF) fees.

A recent survey of 39 FDIC-regulated banks holding 6.5 million accounts found that about one of every four checking accounts became overdrawn at some point over a twelve-month period, and about one out of seven checking accounts was overdrawn five or more times.⁶

If we assume one checking account per adult (excluding those who lack a bank account entirely), an estimated 51 million Americans overdrew their account—and were therefore assessed either an overdraft or NSF fee—over the past 12 months. Perhaps more troubling, over half of those—27 million Americans in all—incur five or more overdraft incidents during the same time period. To put this number into perspective, more Americans overdrew their account at least five times than live in the state of Texas. A majority of accountholders in this category significantly exceeded five overdrafts; nearly two-thirds of these 27 million had ten or more incidents within a one-year period. Table 1 and Figure 1 below detail our calculations.

Figure 1: Share of total checking accounts that become overdrawn during a year and total accountholders affected

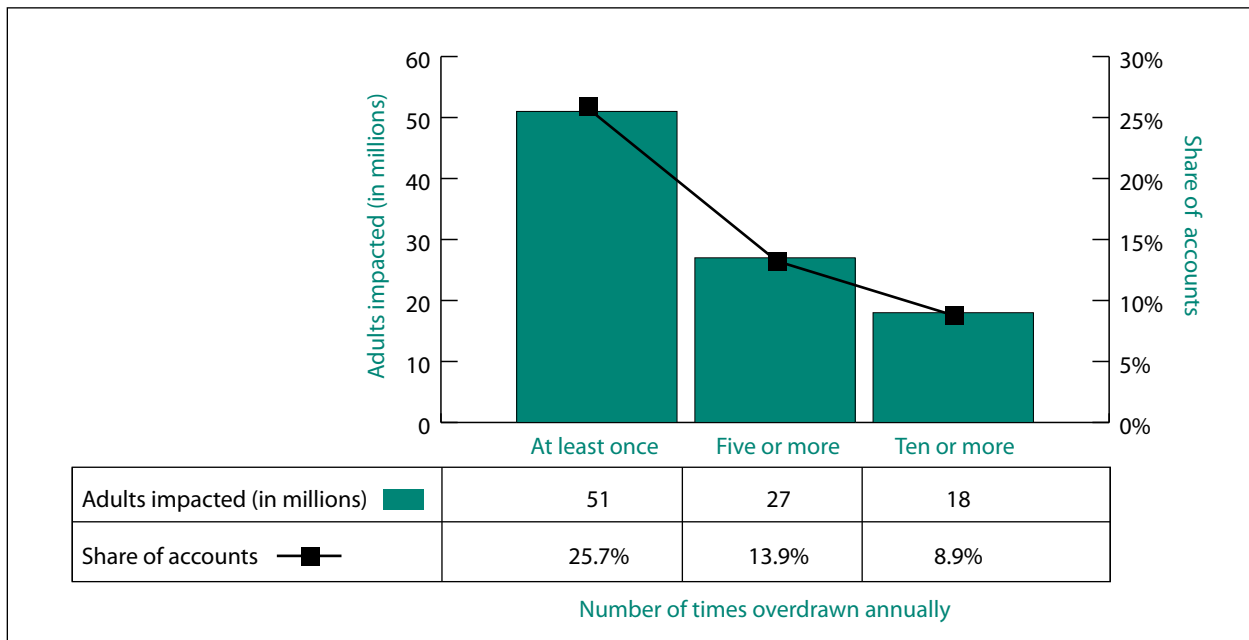


Table 1: Number of adults affected by overdrawn accounts annually

(A) Total population age 18 and over*	225 million
(B) Population without a bank account**	28 million
(C) Total adults with a bank account (C=A-B)	197 million
(D) Adults impacted by at least one overdraft incident (C*25.7%)	51 million
(E) Adults impacted by at least five overdraft incidents (C*13.9%)	27 million
(F) Adults impacted by ten or more overdraft incidents (C*8.9%)	18 million

*2008 Current Population Survey, U.S. Census Bureau

**The FDIC's Alliance for Economic Inclusion estimates that as many as 28 million people in the United States are unbanked.

In previous research, CRL found that consumers who repeatedly overdraw their account are more likely to be low-income, single, non-white, and renters.⁷ In its analysis of the income and age of account holders with overdrawn accounts, the FDIC found that lower-income groups and young adults age 18-25 were the most likely to incur an overdraft or NSF fee.⁸

Finding 2: Banks and credit unions collected nearly \$24 billion in overdraft fees in 2008.

These millions of Americans who overdraw their accounts represent an increasingly significant source of fee income for financial institutions. Banks and credit unions are not required to directly report their total income related to overdraft and NSF fees; however, the FDIC found that nearly three-quarters of its banks' service charge income was the result of overdraft and NSF fees.⁹ Using this breakdown, we estimate that banks and credit unions assessed their customers \$34.3 billion in fees when their accounts became overdrawn in 2008. We estimate that 69 percent of this \$34.3 billion, or \$23.7 billion, is comprised of overdraft fees alone.¹⁰

Table 2: Total overdraft fees collected by banks and credit unions

(A) Service charge income (Banks)*	\$39.5 billion
(B) Fee income (Credit Unions)**	\$6.8 billion
(C) Total service charge/fee income, all banks and credit unions (A+B)	\$46.3 billion
(D) Estimated share of (B) and (C) generated by overdraft and NSF fees***	74%
(E) Estimated total overdraft and NSF fees collected (C*D)	\$34.3 billion
(F) Estimated share of (E) attributable to overdraft fees alone	69%
(G) Estimated total overdraft fees alone (E*F)	\$23.7 billion

*Service charge income as reported in FDIC call report data for 2008.

**Fee income (the equivalent of service charge income for credit unions) as reported by the National Credit Union Administration for 2008.

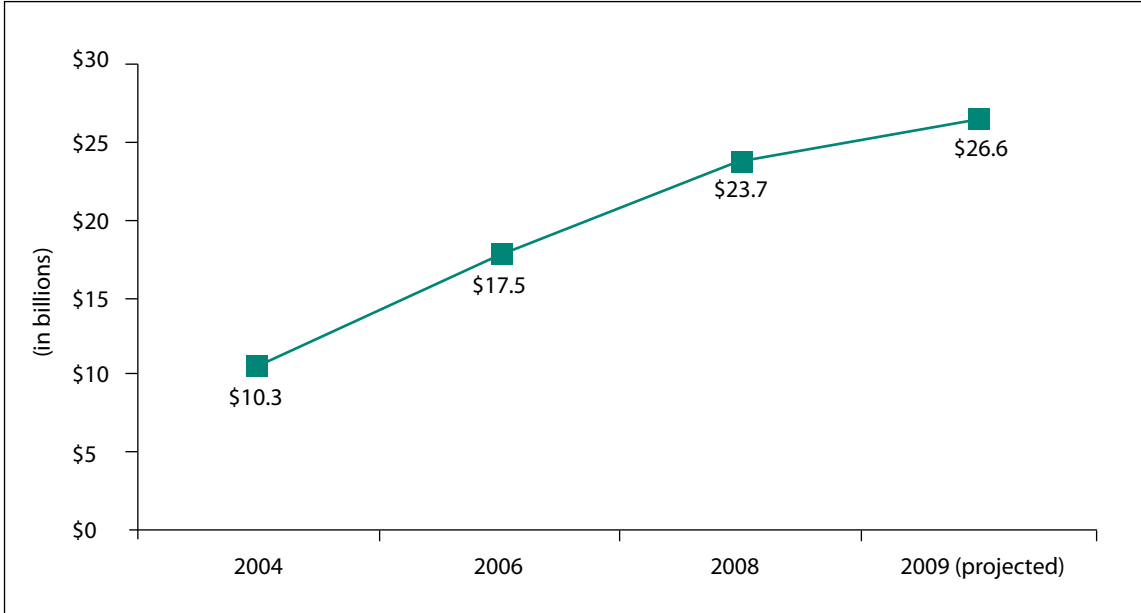
***Based on findings from the 2008 FDIC Study of Bank Overdraft Programs.

These fees are likely to be even higher in 2009. One leading analyst of bank and credit union fees projects that \$38.5 billion in overdraft and NSF fees will be collected this year.¹¹ If our current assumptions hold, overdraft loan fees will comprise nearly \$27 billion of this total amount.¹²

Finding 3: Overdraft fee income for banks and credit unions rose 35 percent from 2006 to 2008.

Our new estimate that consumers paid \$23.7 billion in overdraft fees in 2008 represents a 35 percent increase since our last estimate in 2006. In absolute terms, overdraft fees increased \$6.2 billion in two years—part of a continuing trend that we have observed since our first estimate in 2004, and which we expect to continue through 2009.

Figure 2: Increase in overdraft fees over time



Rising overdraft fees have several underlying sources. First, many financial institutions have increased the fee per overdraft incident and are more frequently charging additional fees if a customer’s account remains overdrawn for several days.¹³ In addition, some banks no longer employ caps on the total fees incurred per day, heightening the chances that someone with multiple transactions will pay hundreds of dollars in fees before even knowing their account is overdrawn.¹⁴

Second, consumers are using debit cards—the most common trigger of overdrafts—both more frequently than in the past and for increasingly small transaction amounts. Today, nearly three-quarters of checking account customers have a debit card, with active card users averaging 17 debit card transactions per month.¹⁵ As a result, debit card usage has exceeded credit card usage since 2005.¹⁶ At the same time, the average debit card transaction size has decreased by about four percent per year, with more than a quarter of all debit card transactions now conducted for purchases of less than \$10.¹⁷ As an analyst from the First Manhattan Consulting Group has noted, “the wide adoption of debit cards had two multiplicative effects: it increased the possibility of a mistake that would take an account negative, and it also increased the number of overdraft events while the customer was unaware he had crossed the line.”¹⁸

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—analyst, First Manhattan Consulting Group

As a result of these trends, service charge income, of which overdraft and NSF fees play an increasingly large part, has steadily increased.

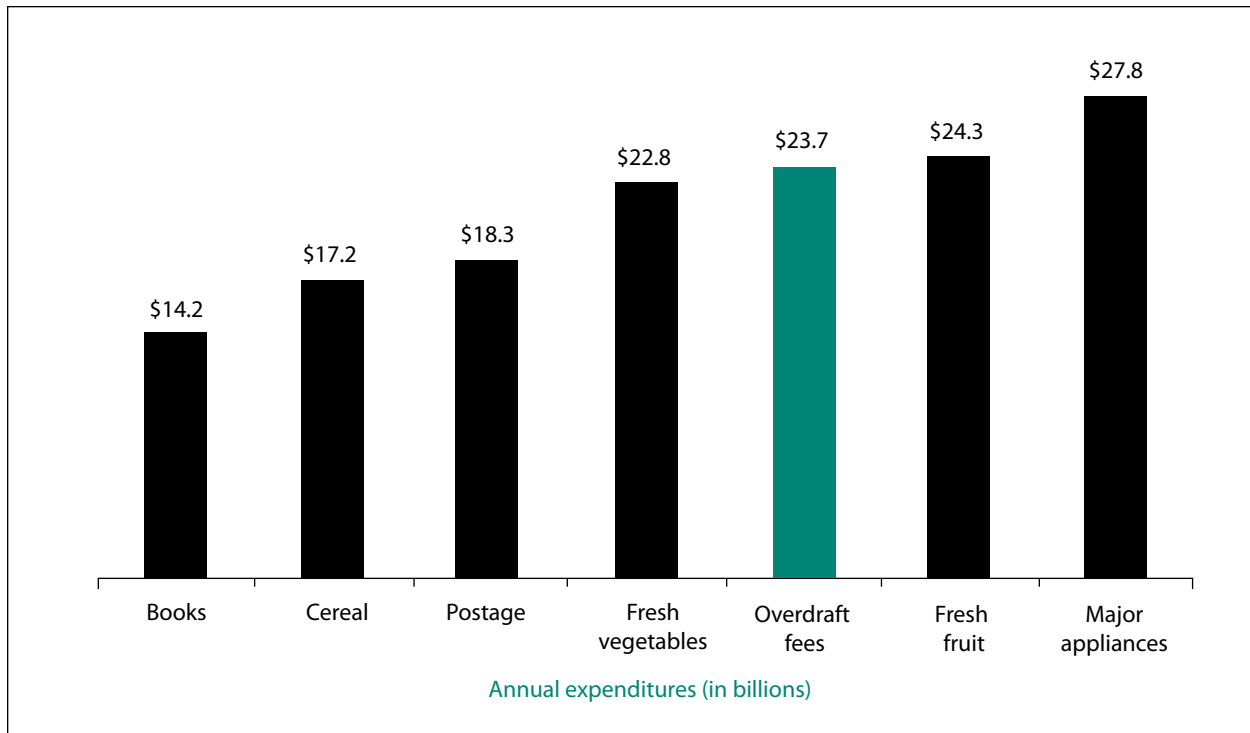
Table 3: Change in overdraft fees collected, 2006–2008

	2006	2008
(A) Service charge/fee income	\$42.2 billion	\$46.3 billion
(B) Share of (A) generated by overdraft and NSF fees	60%	74%
(C) Total overdraft and NSF fees collected	\$25.3 billion	\$34.3 billion
(D) Share of (C) attributable to overdraft fees alone	69%	69%
Total attributable to overdraft fees alone	\$17.5 billion	\$23.7 billion

DISCUSSION

Overdraft fees eat into the already-strained budgets of working families, with Americans now spending far more on overdraft fees annually than they do on common household items such as books, cereal or postage stamps. Americans spend about the same amount on overdraft fees as they do on fresh vegetables every year, and only a little less than they do on fresh fruit.¹⁹

Figure 3: Annual fees resulting from overdrafts, as compared to common household expenditures



Overdraft fees are charged to people who typically are enrolled in an overdraft program without their consent. In most cases—particularly if they are using debit card—survey results show that consumers would rather have their transaction denied than be approved in exchange for a \$34 fee.²⁰

Table 4: Share of respondents who would prefer their transaction be denied at the checkout counter, if account overdrawn, among those with a preference²¹

	Would prefer to be declined
\$5 transaction	80%
\$20 transaction*	79%
\$40 transaction	77%

*The average debit card transaction triggering an overdraft fee is \$20.

Overdraft fees triggered by small dollar transactions, most typically occurring when a debit card is used, are especially pernicious because the credit extended to cover the shortfall is often far smaller than the overdraft fee charged. In previous research we found that, even when accounting for overdrafts caused by checks and other triggers, the overall overdraft fees charged exceed the credit extended.²² For 2008, we estimate that checking account holders receive only \$21.3 billion in credit for the \$23.7 they pay in overdraft loan fees.²³ Put another way, consumers were obligated to repay \$45 billion for \$21.3 billion in extremely short-term credit.²⁴

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The Federal Reserve is currently considering whether—and how—to provide better consumer choice about enrollment in bank overdraft programs.²⁵ As described in our policy recommendations below, however, regulators must go further to curb existing abuses. In addition, Congress is considering larger-scale reforms to overdraft loan programs.²⁶

CONCLUSION & POLICY RECOMMENDATIONS

Each year, over 50 million Americans overdraw their checking account, paying nearly \$24 billion in overdraft fees. Twenty-seven million Americans pay five or more overdraft or NSF fees each year. The most common triggers of these fees are small debit card transactions that could easily be denied for no fee.

Financial institutions engage in abusive practices that maximize overdraft fee revenue. They approve debit card transactions that they could deny for no fee; they charge exorbitant fees that bear no relationship to the cost of covering an overdraft; they charge excessive numbers of overdraft fees over the course of a day, month, or year; and they automatically enroll customers in the most expensive overdraft option available.

As more transactions are conducted through debit cards and banks find new ways to increase their overdraft charges, the cost to accountholders will climb further. Policymakers and regulators can help protect consumers from abusive features of overdraft loan programs by adopting the following recommendations:

Prohibit overdraft fees on debit card purchases and ATM withdrawals. As a limited exception, a fee could be allowed only if the customer were provided a real-time warning and an opportunity to cancel the transaction. Overdraft fees triggered by debit cards could be denied for no fee—the outcome consumers overwhelmingly prefer. As recently as 2004, 80 percent of all institutions denied debit card overdrafts, and at least one large bank and a number of smaller institutions continue to decline debit card transactions that would otherwise result in an overdraft.²⁷ Moreover, the typically small transaction size of debit card transactions means that accountholders often pay more in fees than they receive in credit. Overdraft fees on debit card purchases and ATM withdrawals should either be prohibited altogether, or they should only be allowed if consumers are provided a real-time warning notifying them that the transaction will result in an overdraft and telling them the amount of the overdraft fee. Once this warning is given, the consumer should be given an opportunity to cancel the transaction or use another method of payment.

Require that overdraft fees be reasonable and proportional to the actual cost to the financial institution of covering the overdraft. On average, overdraft fees exceed the amount of credit extended, which is particularly troubling given the short time period until repayment—usually only a few days.²⁸ Since banks are able to repay themselves out of the accountholder's next deposit, these loans carry a low default risk relative to their high cost. Overdraft fees should be proportional to the

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Overdraft fees triggered by debit cards could be denied for no fee—the outcome consumers overwhelmingly prefer.

actual cost to the institution of covering the overdraft, taking into account the cost of funds, default risk, and a reasonable profit margin. Indeed, a product designed to be proportional to the cost to the institution of covering the overdraft already exists—an overdraft line of credit at a reasonable interest rate.

Limit excessive overdraft fees. Consumers who overdraw their accounts frequently may find that overdraft fees beget more overdraft fees, driving them further into debt and ultimately making them less able to meet essential expenses. Once a customer has paid an excessive number of overdraft fees within a 12-month period, the financial institution should be required to provide the customer a longer-term, lower-cost alternative, such as an overdraft line of credit, in order to continue charging the customer for overdrafts. Policymakers should determine what constitutes an excessive number of fees, but it should be no more than six fees per year.

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Prohibit overdraft fees unless the customer has affirmatively consented, or “opted in,” to the institution’s overdraft loan program. CRL surveys have found that nearly 90 percent of accountholders want to choose whether or not to be enrolled in an overdraft loan program.²⁹ Financial institutions should be prohibited from charging an overdraft fee unless the customer has affirmatively agreed to be enrolled.

Require banks and credit unions to comply with the Truth in Lending Act for overdraft loans by disclosing their cost in terms of an annual percentage rate. When a financial institution covers a transaction when there are insufficient funds in an account, they are extending credit to that customer. Regulators should clarify that overdraft fees are finance charges under the Truth in Lending Act and require appropriate disclosures to help consumers compare the cost of borrowing through fee-based overdraft with other alternatives, such as an overdraft line of credit.

Create a Consumer Financial Protection Agency (CFPA) to protect consumers against unfair practices in the financial services industry. While federal regulators have recognized problems with overdraft loan practices since the early 2000s, meaningful reforms have yet to be required. The creation of a new agency focused on consumer protection would provide much needed oversight of products offered throughout the financial services industry, and the CFPA could prohibit abusive banking practices such as those related to overdraft loans.

NOTES

- 1 Debit card transactions (either at the point of sale or ATM) cause 44 percent of total overdrafts, while checks trigger just 27 percent. See Eric Halperin, Lisa James, & Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending (January 25, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf>.
- 2 For an example of how transaction re-ordering can generate more overdraft fees, see Eric Halperin & Peter Smith, *Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending (July 11, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf> at page 5.
- 3 While some financial institutions have recently lowered the number of overdraft fees per day a customer can be charged, these fees can be well in excess of \$100 daily.
- 4 In an analysis of a large database of checking account transactions, CRL found that the median overdraft resulting from a debit card transaction cost the consumer \$1.94 per \$1 borrowed. See Eric Halperin, Lisa James, & Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending (January 25, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf>.
- 5 See survey findings in Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options*, Center for Responsible Lending (April 16, 2008), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/final-caravan-survey-4-16-08.pdf> and *Overdraft Fees and Opting In: A survey of consumer preferences*, Center for Responsible Lending (March 2009) available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/consumer-preference-opt-in.pdf>. In the 2008 survey, 88 percent of respondents reported wanting a choice as to whether their debit card overdrafts would be covered, and more than three-quarters preferred debit card transactions resulting in an overdraft be declined.
- 6 *FDIC Study of Bank Overdraft Programs*, Federal Deposit Insurance Corporation (November 2008), available at http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf. Calculations based on findings in Table IX-11 at page 76.
- 7 Lisa James & Peter Smith, *Overdraft Loans: Survey finds growing problem for consumers*, Center for Responsible Lending (April 24, 2006), available at http://www.responsiblelending.org/overdraft-loans/research-analysis/ip013-Overdraft_Survey-0406.pdf.
- 8 See pages 77-80 of *FDIC Study of Bank Overdraft Programs*, Federal Deposit Insurance Corporation, (November, 2008), available at http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf.
- 9 The FDIC found that, among the financial institutions it regulates that participated in its survey, overdraft and NSF fees made up 74 percent of all service charge income. While the FDIC cautions that this breakdown may not be applicable to all banks and credit unions, several industry analysts, including Bretton Woods and Moebs Services, have found similar results across financial institutions. See *FDIC Study of Bank Overdraft Programs*, Federal Deposit Insurance Corporation (November 2008), available at http://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf.
- 10 In an analysis of a large database of checking account transactions, we found that overdraft fees were assessed 69 percent of the time when a consumer overdrew their account, while NSF fees were incurred only 31 percent of the time. See Eric Halperin & Peter Smith, *Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending (July 11, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf>.
- 11 Mike Moebs of Moebs Services, Inc. projects \$38.5 billion in overdraft and NSF fees will be collected in 2009, with roughly 70 percent, or \$27 billion attributable to overdraft fees alone. See Ron Lieber & Andrew Martin, *Overspending on Debit Cards is a Boon for Banks*, *The New York Times* (September 8, 2009).
- 12 Using our current assumption that overdraft fees alone comprise 69 percent of total overdraft and NSF fees, we project \$26.6 billion in overdraft fees for 2009 based on Mike Moebs' projection (\$35.8 billion * 69% = \$26.6 billion), which approximates Moebs' own projection of \$27 billion.
- 13 Jean Ann Fox, *Fees for Unauthorized Overdraft Loans Keep Going Up at Largest Banks: Consumers need better protections to safeguard bank accounts*, Consumer Federation of America (July 31, 2009), available at http://www.consumerfed.org/pdfs/OD_CFA_bank_fee_survey_release_2009_final.pdf.
- 14 Jean Ann Fox, *Fees for Unauthorized Overdraft Loans Keep Going Up at Largest Banks: Consumers need better protections to safeguard bank accounts*, Consumer Federation of America (July 31, 2009), available at http://www.consumerfed.org/pdfs/OD_CFA_bank_fee_survey_release_2009_final.pdf.
- 15 *Despite Recession, Card Issuers Expect Debit Growth in 2009: 2009 Debit Issuer Study, commissioned by PULSE, reveals greater PIN debit use and lower fraud losses*, Pulse Network (June 4, 2009), available at https://www.pulsenetwork.com/public/upload/storage/file250/file/2009-Debit_Issuer_Study_Release.pdf.
- 16 In 2005, there were 26 billion debit card transactions, compared to 22 billion credit cards transactions. Debit card usage is expected to increasingly exceed that of credit cards, with a projected 46 billion debit card transactions compared to 30 billion credit card transactions by 2012. Data from *The Nilson Report*, November 2008, Issue 914.
- 17 According to the 2007 *Federal Reserve Payments Study*, the average value per signature debit card transaction decreased by 4.3 percent per year in constant dollars from 2003 to 2006, and the average value per PIN debit card transaction decreased by 3.9 percent per year during the same time period. See *The 2007 Federal Reserve Payments Study: Noncash payment trends in the United States, 2003-2006*, Federal Reserve System

(December 10, 2007), available at http://www.frbservices.org/files/communications/pdf/research/2007_payments_study.pdf. The *2009 Debit Issuer Study* found that 27 percent of debit card transactions in 2008 were for less than \$10. See *Despite Recession, Card Issuers Expect Debit Growth in 2009: 2009 Debit Issuer Study, commissioned by PULSE, reveals greater PIN debit use and lower fraud losses*, Pulse Network (June 4, 2009), available at https://www.pulsenetwork.com/public/upload/storage/file250/file/2009-Debit_Issuer_Study_Release.pdf.

18 *Recrafting the Checking Account Product Line: Responding to the Unhappily Unbanked*, First Manhattan Consulting Group (2009).

19 The 2007 Consumer Expenditure Survey conducted by the Bureau of Labor Statistics finds that households spend, on average, \$118 on reading materials, \$143 on cereal, \$152 on postage and stationary, \$190 on fresh vegetables, \$202 on fresh fruits, and \$231 on major appliances. To calculate the total consumer expenditures, we multiply these amounts by the 120,171,000 U.S. households. For more information, see <http://www.bls.gov/ce/>. A similar analysis was performed by consulting firm Oliver Wyman, see Aaron Fine, Andrew Dresner, & David Goldberg, *Insufficient Funds: The outlook for deposit fees and implications for banking institutions*, Oliver Wyman (2009).

20 See survey findings in Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options*, Center for Responsible Lending (April 16, 2008), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/final-caravan-survey-4-16-08.pdf>.

21 Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options*, Center for Responsible Lending (April 16, 2008), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/final-caravan-survey-4-16-08.pdf>.

22 CRL found that banks and credit unions collected \$17.5 billion in overdraft fees in 2006, while only extending \$15.8 billion in credit. See Eric Halperin & Peter Smith, *Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending, (July 11, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf>.

23 In our 2006 study, we found that credit extended equated to 90.1 percent of total overdraft fees. Using these same assumptions for 2008, banks and credit unions collecting \$23.7 billion in overdraft fees would extend only \$21.3 billion in credit ($\$23.7 \text{ billion} * 90.1\% = \21.3 billion). See the appendix of Eric Halperin & Peter Smith, *Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending (July 11, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/out-of-balance-report-7-10-final.pdf> for methodology.

24 Consumers who overdraw their accounts must repay the amount of credit extended in order to bring their account balance back above zero as well as the fees incurred. This equates to \$45 billion dollars (\$21.3 billion in credit + \$23.7 billion in fees).

25 The Federal Reserve is considering changes to Regulation E which would impact overdraft loan programs, see <http://edocket.access.gpo.gov/2009/pdf/E8-31184.pdf>.

26 Reforms to overdraft loan programs have been introduced by Rep. Carolyn Maloney (D-NY) as HR 1456, the Consumer Overdraft Protection Fair Practices Act.

27 For example, in most circumstances, Citigroup will not approve a debit card transaction or charge an overdraft fee if the transaction if the customer lacks adequate funds.

28 Previous CRL research has found that consumers pay their overdraft fees and bring their accounts back above zero within 2-5 days, on average. See Eric Halperin, Lisa James, & Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending (January 25, 2007), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/Debit-Card-Danger-report.pdf>.

29 Leslie Parrish, *Consumers Want Informed Choice on Overdraft Fees and Banking Options*, Center for Responsible Lending (April 16, 2008), available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/final-caravan-survey-4-16-08.pdf> and *Overdraft Fees and Opting In: A survey of consumer preferences*, Center for Responsible Lending (March 2009) available at <http://www.responsiblelending.org/overdraft-loans/research-analysis/consumer-preference-opt-in.pdf>.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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