Bounce Protection: Banks Answer to the Pay Day Loan

An Examination of Bounce Protection Plans

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National Consumer Law Center

Full text and footnotes of the original article are available at:
http://www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml

Have you been getting new advertisements from your bank touting their latest consumer service, a "Bounce Protection" plan? Hundreds, if not thousands, of banks nationwide are adopting these new programs, promising consumers to save them from the embarrassment of Not Sufficient Funds notices and to stretch their funds between paydays. While that sounds great, the banks are generally not telling you, unless you ask, that the fees and charges associated with these plans can amount to the equivalent of an annual interest rate of 200, 300 or even 400%. These products are based on overdraft protection, but are not traditional overdraft lines of credit or the occasional ad hoc practice where a bank will cover a consumer's bounced check as a courtesy. Instead, they are deliberate, systemic attempts to hook consumers onto overdrafts as a form of high cost credit. To distinguish these products from traditional overdraft lines of credit and from the occasional, ad hoc coverage of an overdraft, we will refer to these plans as "bounce protection."

Description of Bounce Protection Plans

Bounce protection works like this: Participating banks advertise to consumers that they will cover overdrafts up to a set limit for accounts in good standing and will charge the bank's standard Not Sufficient Funds (NSF) fee for each overdraft. While plans vary by bank and by the consultant's program employed by each bank, some common features characteristic of these plans are:

- Consumers do not affirmatively agree to coverage; instead the bank imposes coverage to a subset of account holders as a "courtesy" or additional service feature of their account. Consumers who do not want this "courtesy" must explicitly opt out by contacting the bank.

- A much larger proportion of bank customers are covered, compared to traditional overdraft lines of credit, because customers do not sign up for the plan.

- All participating banks impose a per item fee, generally the bank's standard NSF or overdraft fee which is usually a flat $20 to $35. Some banks also charge a per day fee, such as $2 or $5 per day, until the consumer has a positive balance in their account.

- Banks deduct the amount covered by the plan plus the fee by setting off the consumer's next deposit. This is true even when the deposit is protected income, such as a welfare or social security check.

- Bank customers are not given Truth in Lending disclosures regarding the cost of bounce protection, which can be astronomical.

- Bounce protection coverage can be accessed through payment methods other than checks to third parties, including:

- Automated Teller Machines
- Debit Cards
- Checks and other debits cashed at the teller windows
- Online banking or voice banking line
- Automated Clearing House (ACH) debit transactions (automatic bill payments deducted from your account)

- Consumers are informed they have bounce protection "limits," which are shown as "available" amounts when consumers access information about account balances. At ATMs, the account balance includes the amount of the bounce protection (but the ATM does not disclose the fee for accessing cash from bounce protection). Some banks include the bounce protection limit in the available balance quoted in online banking and telephone banking. However, some banks do not enforce these limits and allow consumers to exceed them.

- Overdrafts must be repaid or accounts brought to a positive balance within a set period of time, generally anywhere from a few days to 30 days.

If calculated as finance charges, the Annual Percentage Rates for bounce protection fees are astronomical. For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243%. If the consumer pays the overdraft back in 14 days, which is probably more typical for a wage earner, the APR is 541%. These APRs are probably the bottom end of the scale.

Over 1000 banks, mostly smaller community banks, have implemented bounce protection plans. Of the large national banks, Washington Mutual Bank appears to be the largest provider of bounce protection. 10 other large banks offering bounce protection include TCF of Minneapolis and Fifth Third of Cincinnati. To get a sense of whether banks subject to all of the federal regulatory agencies were adopting "bounce protection," we conducted an Internet search using the Google search engine on the phrases "overdraft privilege" and "bounce protection." This search turned up 32 FDIC regulated banks, five Federal Reserve regulated banks, 15 national banks, 3 thrifts, and a Texas credit union. This was not an exhaustive search, but demonstrates that all types of bank charters are adopting these programs.

The aggressive marketing banks use to push these programs promises that these programs provide security and piece of mind. However, that claim may run afoul of the Truth in Lending laws that require full disclosure for all loans. Banks avoid these laws by claiming these programs are discretionary services provided to their customers, not a formal credit arrangement. So not only are the interest charges astronomical, there is no guarantee the bank will, in fact, cover an overdraft.

Comparison with Overdraft Lines of Credit and Other Contractual Plans

In contrast to bounce protection, banks offer a much more reasonable credit product to the customers to avoid bounced checks – overdraft lines of credit. Banks also offer programs where overdrafts are covered by the consumer's credit card or by transfers from a savings account. These products offer a better value to consumers, as well as including Annual Percentage Rate disclosures for the credit products so that consumers can shop around and know what they are getting.

Interest rates for overdraft lines of credit are generally around 18% APR. Over 80% of banks offer these lines of credit. Less than half of these banks also charge an annual fee of about $15 to $20.

A customer who applies for an overdraft line of credit must meet credit-worthiness criteria. Relatively few account holders apply for and qualify for contractual overdraft protection. One of the banking consultants who offers bounce protection explicitly stated why banks do not promote these lines of credit and prefer bounce protection: traditional overdraft programs are not as profitable (because they do not charge astronomical fees), and customers who bounce checks are reluctant to apply for overdraft protection and may not qualify.

The Banks' Competition for Payday Loan Business

Payday loan companies make very short-term loans to bank account holders who don't have sufficient funds in their bank accounts. Payday loans cost on average 470% APR and involve loans based on personal checks held for future deposit. There has been severe criticism of payday loans by consumer groups.

Yet in some ways bounce protection is even worse than the scourge of payday loans. The APRs for bounce protection can be several times that of payday loans, which are already grossly usurious. Furthermore, at least payday lenders are required to provide Truth in Lending disclosures.

Consumers are likely to incur higher dollar amounts with bounce protection fees than payday loans. A typical payday loan consumer may pay $50 for a $400 loan of 2 weeks, which is already an excessive fee. A consumer who borrows that much from a bounce protection plan faces a real possibility of paying more, because the consumer will have accessed the credit using multiple payment methods and incurring multiple fees. For example, the consumer might have overdrawn $400 by writing 3 checks for $100, withdrawing $100 from an ATM, and using their debit card to pay $100. Since they will have made 5 transactions that overdrew their account, they will be charged 5 times for probably at least $20 – making that $100 in fees or twice the payday loan fee.

What You Should Do

If you need some sort of overdraft protection, consider applying for the traditional overdraft line of credit. Interest rates are about the same as credit cards: high, but much better than the effective APR of the bounce protection plan. If your bank offers what sounds like a workable bounce protection plan, make sure you sit down with a bank representative and get full disclosure of ALL the fees and charges associated with each use of the bounce protection plan before you write a check for more than your account balance. Finally, ask if your bank has applied Bounce Protection to your account without your consent. You may have received notice of the new "service" in a mass mailing that you didn't read carefully. If so, your bank may try to impose fees beyond the traditional "Not Sufficient Funds" penalties the next time you inadvertently overdraw your account. Remember, knowingly writing a check with insufficient funds can negatively impact your credit rating and is a criminal offense in most states. The banks cannot promise to cover your overdrafts without running afoul of the truth in lending acts. In spite of all the flowery language in their advertisements, your bank is not contractually obligated to cover what is still an overdraft. Don't depend on your bank's advertising promises to protect your credit rating and keep you from appearing in front of a judge.

If you have questions on this topic, please call the Legal Services Center, Fort Monmouth, NJ, (732) 532-3471. Point of contact is MAJ Tom Adams.