

Changing laws and regulations notwithstanding, many checking customers will continue to look to banks for help in dealing with account overdraft incidents.

The Hidden Life of Frequent Overdrafters

BY HANK ISRAEL

Acting under the banner of consumer protection, lawmakers and regulators have rushed to the defense of checking customers who frequently overdraw their accounts. One impetus is a popular perception that account overspending would plummet if households were better informed about the consequences and could decline checking account overdraft coverage altogether.

However, findings from a recent national survey conducted by Novantas and Informa Research Services paint a very different picture of frequent overdrafters. In many cases, research indicates, their aggressive spending behavior likely will continue despite changes in laws, regulations and account terms and conditions.

The Novantas-Informa survey explodes the myths about this group:

Myth Number One: Overdrafts mostly occur among low-income groups – The fact is that frequent

overdrafters come from all walks of life and all income tiers. Roughly two-thirds of these customers earn more than \$40,000 annually.

Myth Number Two: Overdraft charges typically come as a surprise – To the contrary, frequent overdrafters are quite conscious of their spending patterns, implying strong ongoing demand for banking services that will help them to deal with temporary account shortfalls. Among frequent overdrafters, 91% of survey respondents said they were personally responsible. Spousal spending was additionally cited by 20% of respondents. By contrast, banks were blamed by just 10% of respondents for overdraft incidents.

Myth Number Three: Overdraft volume will collapse once new rules take effect – In most cases, overdraft incidents are attributable to ingrained household spending habits, financial contingencies, and mix-ups in account management and household communication – not a lack of income or knowledge. In this light, it is reasonable to expect continuing household demand for checking account overdraft coverage.

Given that frequent overdrafters likely will not “go away” and the demand for bank-supplied overdraft coverage will continue in some form or fashion, there will be a strong opportunity for checking-related product innovation. A variety of options are quickly surfacing that will help customers to deal with temporary balance shortages in their accounts.

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THREE DIMENSIONS OF RESPONSE

Many frequent overdrafters likely will “opt-in” to receive traditional exception-handling services from their banks. And many of those who eschew such services will wind up wanting alternative arrangements, such as electronic notification and standby revolving credit. In either case, banks will play a key role in helping households to deal with checking-related payment contingencies.

As they develop innovative new products that will help to bridge account shortfalls among frequent overdrafters, banks will respond along three dimensions:

- 1) *Access*, which considers immediate options to either invoke bank overdraft coverage or to transfer funds from other customer accounts;
- 2) *Payment Horizon*, which considers various deferred payment options that allow customers to repay an account overdraft at a later date; and
- 3) *Pricing*, which considers various fee-based arrangements that will help customers to mitigate overdraft incidents, and also alternative fee structures depending on product design and risk.

Banks already have adopted sharply differing strategies for overdraft coverage, with some institutions simply dropping the traditional service altogether and others aggressively encouraging customers to opt-in, as specified under Reg E.

Beyond the basic are new alternatives for overdraft coverage based on funds transfers from other accounts held by the customer. One arrangement transfers funds automatically in the event of an overdraft, for example, and the other allows the customer to manually transfer balances on a case-by-case basis.

Many customers need help in handling big-ticket contingency expenses for items such as auto repairs, medical services and housing upkeep.

Innovative banking solutions include providing an advance against the next paycheck; converting the overdraft item into a short installment loan; or helping the consumer to fund account contingencies with a revolving credit facility.

It is important to craft fee arrangements that will encourage the use of new products and services

while adequately compensating the institution for operating expenses, financing arrangements, and default risk on overdrawn accounts.

For example, in some cases there may be interim finance charges on deficit transactions that have been covered by the institution but not yet repaid by the customer. In other cases monthly fee arrangements may be appropriate for standby funds transfer capabilities. In still other cases, some combination of a transaction fee and a financing charge will be appropriate when a deficit check is converted into short-term credit.

ONGOING NEEDS

While no one would say that frequent overdrafters are happy about the exception fees they incur, it is clear that an essential bond of trust remains with banks, which are counted on to provide rock-solid support when accounts are overdrawn.

Indeed, many respondents to the Novantas-Informa survey acknowledge that bank-provided overdraft coverage helps them to avoid other types of payment default consequences, including creditor-imposed late payment fees of much higher magnitude than the bank-imposed overdraft fees that currently occupy Washington’s attention.

The bottom line is that banks have a rational basis for continued service to frequent overdrafters. Changing laws and regulations notwithstanding, many customers will continue to need help in dealing with account overdraft incidents, and they will be looking to banks for innovative solutions.

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