



Consumer Federation of America

BOUNCED CHECKS: BILLION DOLLAR PROFITS II¹

June 1998

According to an analysis prepared for the Consumer Federation of America (CFA), banks are generating billions of dollars in profits from fees assessed on bounced checks and the resulting returned deposits. Bankers are using a variety of consumer-unfriendly schemes to boost bounced check revenue.

FINDINGS

1. Banks generate more than \$6.1 billion in annual profits on fees for bounced checks and returned deposit items.

Banks generate more than \$5.6 billion in annual revenue and \$5.2 billion in annual profits from bounced checks. Deposit-item-returned (DIR) fees, assessed on the depositor of a check that bounces, generate more than \$1.1 billion in annual revenue and \$918 million in annual profits for banks. Both fees have increased at rates higher than inflation.* (See Methodology section for calculations.)

Even if check-fraud losses of \$600 million annually are deducted, profits from bounced check and DIR fees exceed \$5.5 billion per year.

¹This report was prepared by Janice C. Shields, Ph.D., Consumer Rights Advocate and Director, Institute for Business Research, Washington, DC. The report updates CFA's December 1993 *Bounced Checks: Billion Dollar Profits* by Chris Lewis, then CFA's Director of Banking and Housing Policy, and Janice C. Shields. That report calculated profits from bounced checks alone of \$3.67 billion. However, the 1993 and 1998 profits aren't entirely comparable due to changes in how the industry reports data.

²*Annual Report to the Congress on Retail Fees and Services of Depository Institutions*, Board of Governors of the Federal Reserve System, Washington, DC, 1997.

³*Report to the Congress on Funds Availability Schedules and Check Fraud at Depository Institutions*, Board of Governors of the Federal Reserve System, Washington, DC, 1996.



2. Bounced check fees are 11 to 32 times banks' costs and DIR fees. 9 to 11 times costs.

According to the Federal Reserve Board's most recent *Annual Report to the Congress on Retail Fees and Services of Depository Institutions* (June 1997), banks assess average bounced check fees of \$16.36 and average DIR fees of \$5.50. Mentis Corporation estimates that banks incur average transaction costs of \$.50 to \$1.50 to process bounced checks and \$.48 to \$.65 for DIRs.⁴ Thus, bounced check fees range from 11 to 32 times costs, and DIR fees, 9 to 11 times costs.

3. Sixty-four percent of consumers surveyed believe that fees of \$17 per bounced check are too high; only 5 percent felt fees were too low.

In May 1998, Opinion Research Corporation International (ORCI) surveyed 1005 consumers for CFA, to determine views of bounced check fees and related bank practices. Forty-four percent responded that a \$17 fee per bounced check was much too high and 20 percent believed that the fee was somewhat too high. Twenty-seven percent felt that \$17 was "about right," 2 percent said the fee was somewhat low and 3 percent replied that \$17 was much too low. (Four percent didn't know.)

4. Only 5 percent of bankers report a decrease in the number of bounced checks when fees are increased.⁵

Bankers claim that they assess high fees to discourage customers from bouncing checks. Yet, 95 percent of bankers report no drop in the number of bounced checks after fees are increased. As one industry consultant said, "NSF [bounced] check fees are a source of income that's yours for the taking."⁶

When bank fees are criticized, bankers reply that the fees must be acceptable because consumers pay them. However, consumers know they must pay their bounced check fees to keep their accounts and avoid developing a bad record with reporting companies like Chextra, which are similar to credit reporting agencies. Additionally, tricks used by bankers can cause even careful consumers to bounce checks. (See #5 below.)

5. Most consumers prefer that banks clear checks in the order received: bankers claim that consumers want their biggest checks cleared first - which generates more bounced check fee revenue for banks.

⁴"ATMs lowering bank transaction costs," *Bank Rate Monitor*, July 1997, p. 7.

⁵ *Pricing Financial Services 1995*, Sheshunoff Information Services Inc., Austin, TX.

⁶Haberfield, Ralph, *Savings Institutions*, March 1991, p. 34.

Bankers have devised a number of traps to rack up bounced check fees. One of their favorites involves programming computers to deduct a customer's biggest checks first on any given day, which can increase the number of bounced checks and the fees assessed.

For example, assume a consumer has **\$800** in an account, deposits a check for \$600, and writes checks for \$400, \$350 and \$500, which arrive in that order at the bank for payment on the day before the deposit clears. If the bank clears the checks in the order in which they arrive, the consumer will incur only one bounced check fee [**\$800** - \$400 - \$350 = \$50; \$500 check bounces]. If the computer is programmed to subtract the biggest checks first, the bank will collect two bounced check fees [**\$800** - \$500 = \$300; \$400 and \$350 checks bounce].

Bankers claim that customers prefer that the largest checks be processed first because these usually cover the most important bills, such as mortgage payments. In May 1998, ORCI also asked the 1005 respondents to identify the order in which they preferred their banks to process checks. Contrary to the bankers' claims, only 13 percent wanted their banks to clear the largest checks first. Sixty-four percent responded that they preferred that the bank pay the checks in the order in which the bank receives them. Sixteen percent said they wanted their bank to pay the smallest check first, to minimize the number of checks that bounce. (Six percent didn't know.)

Other tactics used by bankers to boost bounced check revenue include:

- *Charging higher fees for an "excessive" number of bounced checks
- *Eliminating daily limits on bounced check charges
- *Eliminating "free zones" -- assessing fees even for small checks that bounce
- *Penalizing bank employees who waive a customer's bounced check fee'

6. the type of institution, the geographic location of the bank, and the type of account.

Size of Institution:

According to the Federal Reserve Board's *Annual Report to the Congress on Retail Fees and Services of Depository Institutions* (June 1997), large banks assess bounced check fees of **\$20.29**; medium-sized banks' average fees are **\$18.97**; and, small banks charge **\$15.05**. The Fed's *Annual Report* also disclosed that 85 percent of large banks assess DIR fees, compared to 69 percent of medium-sized banks and 54 percent of small banks.

⁷20 Ways to Increase Income from NSF and OD Fees, Siefer Consultants, Storm Lake, IA

Type of Institution:

According to the CFA/CUNA report, *Banks Charge More Fees and Higher Fees Than Credit Unions* (February 1998), banks assess bounced check fees of \$17.39, while credit unions' fees average \$15.42.

Location of Bank:

The Federal Reserve Board's *Annual Report to the Congress* disclosed that multistate banks assess bounced check fees of \$19.22 and DIR fees of \$6.07; single-state banks averaged bounced check fees of \$15.90 and DIR fees of \$5.39.

Average bounced check fees also vary considerably by market. According to *Bank Rate Monitor's* 1997 check study,⁸ fees of \$28.29 in Philadelphia were the highest of the 25 markets surveyed; average fees of \$11.71 in Los Angeles were the lowest. Detroit's fees of \$20.89 fell in the middle.

The following states have established caps on bounced check fees:

State	Bounced Check Fee Limit
Idaho	\$15
Missouri	\$20
Montana	\$30
Nevada	\$25
New York	\$15
South Dakota	\$30
Tennessee	\$20

Source: American Bankers Association, May 1998

⁸"How markets rank on pricing," *Bank Rate Monitor*, April 1997, p.7.

Type of Account:

Some banks assess higher bounced check fees on "free" or basic no-frills accounts -- up to double the fee charged on regular accounts.⁹ Higher fees on basic no-frills accounts are of particular concern to CFA and the Institute for Business Research because this potentially hits hardest the low-income consumers to whom these accounts may be targeted but who can least afford the fees. Unbanked consumers may soon face a slew of bank fees, such as these doubled charges on bounced checks. In 1999, the 10 million recipients of federal checks who currently do not have bank accounts may have to establish accounts to receive the checks electronically.

Payday loan sharks have exploited financially-strapped consumers' concerns about bounced check fees assessed by banks and merchants, by advertising the loan "service" as a way to avoid those charges. In a payday loan, the lender agrees to accept and hold a borrower's personal check, for a fee, until the borrower's next payday and provide cash immediately -- the loan. On payday, the borrower either repays the lender and takes the personal check back or deposits the paycheck in a bank account so that the lender can cash the personal check or renews the loan by paying another fee. According to CFA's report, *The High Cost of "Banking" at the Corner Check Casher* (September 1997), effective annual interest rates on payday loans range from more than 200 percent to 1800 percent.

OVERDRAFT PROTECTION

Consumers can avoid some fees related to bounced checks by arranging in advance for overdraft protection, with their financial institution. Then, if the consumer writes a check in excess of the checking account balance, the bank will pay the check anyway.

There are three major types of overdraft protection: (1) the bank transfers money from the consumer's savings account to the checking account to cover a check that would have bounced; (2) the bank loans the consumer money by making a deposit to the checking account to cover the check written; or, (3) the bank pays the check and adds that amount to the consumer's credit card bill.

Overdraft protection enables consumers to avoid charges assessed by recipients of bounced checks, such as merchants and landlords. However, the cost of overdraft protection may be high. According to the American Bankers Association's *1997 Retail Banking Survey Report*, almost 17 percent of large banks assess customers an annual fee of \$15 just to have overdraft protection available, even if no checks bounce. Large banks charge 16.50 percent interest if they loan an account holder money by making a deposit so the check can be covered. Additionally, banks provide *minimum* lines of credit that average \$300, even though the check that would have bounced may be less. For example, if a consumer with overdraft protection writes a check for

⁹"OD Fee on Bank's Free DDA Is Double the Regular Fee," *Fee Income Report*, October 22, 1992, p. 7.

\$25 but only has a balance of \$10, the bank will lend that account holder \$300 by depositing the \$300 into the checking account. The bank will then clear the \$25 check and charge 16.50 percent interest on \$300, even though the account holder only needed \$15 (\$25 - \$10).

If the overdraft protection bills the account holder's credit card to pay checks that would have bounced, interest may be assessed for the full billing period. In one case referred to the Institute for Business Research by the victim, the account holder's bank transferred money to his checking account by billing his credit card the last hour of the last day of his billing cycle. Yet, he was assessed interest as if the transfer had occurred on the first day of the cycle.

Consumers can avoid interest charges if the overdraft protection transfers money from a savings to checking account to cover checks written. However, consumers may face a fee for each check covered by such a transfer. In another case referred to the Institute for Business Research, a consumer with overdraft protection from her savings account was shocked when she was assessed fees equivalent to two bounced check fees, after the bank had made three transfers from her savings account to cover checks. The bank's overdraft "protection" allowed only one free transfer per quarter.

RECOMMENDATIONS FOR CONSUMERS¹⁰

1. Keep your checkbook balanced.

Increasingly, deductions from checking accounts result from electronic transactions, such as ATM withdrawals and debit or point-of-sale purchases, rather than paper checks. Banks also promote checking cards, which look like credit cards but withdraw the amount of the purchase from the account immediately. Additionally, the number of bank fees that may be automatically subtracted from accounts has been rising. To avoid bouncing checks, consumers - especially those with joint accounts -- should deduct these transactions immediately.

2. Know the laws and your bank's deposit practices,

In general, federal law requires that banks clear deposits of local checks within 2 business days and nonlocal checks within 5 business days. If a check you've

¹⁰The Institute for Business Research also recommends that consumers become active in Financial Consumers Associations (FCAs). FCAs are groups of financial consumers who join forces to (1) educate consumers about financial alternatives, (2) lobby state and federal legislators and regulators for consumer-friendly laws and rules, and (3) bring legal action against financial institutions. For more information and a brochure on FCAs, please contact Janice Shields (202-387-5190), Institute for Business Research, P.O. Box 19793, Washington, DC 20036 or via e-mail at <jshields@igc.apc.org>.

written comes to your bank before the money you deposited to cover the check is available, the bank may bounce that check.

Your bank may record branch and ATM deposits made after a certain hour, for example, 2 p.m., as occurring the *next* business day, even though the bank may remain open after that hour. Look for signs in the branch or at the ATM or ask what your bank's practices are.

If your checks are direct-deposited, know when that money is available to cover checks you may write. Ask the payor for a schedule of deposit dates and check with your banker about funds availability. To encourage direct deposits, some banks make the money available at the beginning of the day of the deposit.

3. If you incur a bounced check or DIR fee, ask for a fee waiver.

Bank tellers and managers often have the authority to waive fees assessed, especially for good customers who rarely bounce checks or deposit checks that bounce. However, consultants are recommending that banks limit or abolish waivers, to increase fee revenue.

4. Arrange to have overdraft protection if the cost is less than your bounced check fees.

Calculate the total fees that you paid your bank and recipients (e.g., grocery stores, landlords) of your bounced checks during the past year. Compare that total to the costs you would have incurred had you arranged to have overdraft protection. Set up overdraft protection if those costs would have been less than or equal to the bounced check fees you paid.

5. If you don't like your bank's fees and practices, find another financial institution.

First, assess how you use your bank account, i.e., do you infrequently if ever bounce checks? Do you primarily use ATMs? Then shop for the financial institution that best and most inexpensively meets your needs. Small banks, single-state banks and credit unions usually assess lower fees. Brokerages firms also now offer checking-type accounts.

RECOMMENDATIONS FOR LEGISLATORS AND REGULATORS

1. Require banks to process all deposits for the day before paying checks from the account and to clear checks in the order in which the banks receive them.

Bankers should not be permitted to manipulate the deposit and check clearing process to intentionally create bounced checks and the resulting fee revenue.

2. ~~Cap bounced check and DIR fees.~~

CFA recommends that Congress cap bounced check and DIR charges at amounts equal to costs plus a reasonable profit, in order to prevent fee-gouging. As indicated previously, a number of states have already legislated maximum bounced check fees.

3. Prohibit assessment of higher bounced check fees on accounts proposed for recipients of federal payments and on basic/no-frills accounts. unless banks can prove that higher costs are incurred.

When high fees are paid by recipients of government checks, the taxpayers end up subsidizing financial institutions, rather than the intended beneficiaries.

METHODOLOGY

To calculate the profits on bounced check and DIR fees, we first determined the number of bounced checks that would be assessed a fee. We calculated the bounced check revenue by multiplying the average bounced check fee times the number of bounced checks assessed the fee; the banks' costs of bounced checks were calculated by multiplying the number of checks that bounce times the banks' costs incurred per check. We calculated the number of DIR checks for which fees would be assessed by multiplying the percentage of banks that assess DIR fees times the number of bounced checks. We then multiplied the number of DIR fee checks times the average DIR fee to determine DIR revenue; we multiplied the number of DIR checks times the banks' cost per DIR check to determine aggregate costs. We calculated profits by subtracting costs from revenues.

Data on the number of checks cashed and the number that bounce were obtained from the American Bankers Association's 1997 *Retail Banking Report* and court cases. Average fees and the percentage of banks assessing the fees were obtained from the Federal Reserve Board's *Annual Report to the Congress on Retail Fees and Services of Depository Institutions* (June 1997). Banks' costs were obtained from the Mentis Corporation, a research firm used by the banking industry.

See appendix for ORCI questionnaire and responses.

APPENDIX

Opinion Research Corporation International Questionnaire and Responses

- I. Banks now charge an average fee of \$17 to handle a check bounced for insufficient funds. Do you believe the fee is:

	<u>Number of Respondents</u>	<u>Percentage of Respondents</u>
Much too high	444	44%
Somewhat high	196	20
About right	269	27
Somewhat low	25	2
Much too low	28	3
Don't know	43	4

11. When there are insufficient funds in an individual's checking account, many banks clear the largest checks first, claiming that those are the most important. Clearing the largest checks first increases the number of smaller checks that bounce and raises consumers' bounced check fees. If you have insufficient funds in your account to cover the checks you've written, which of the following would you prefer your bank to do?

	<u>Number of Respondents</u>	<u>Percentage of Respondents</u>
Pay the checks in the order in which the bank receives them	648	64%
Pay the smallest check first, to minimize the number of checks that bounce	161	16
Pay the largest checks first, since those may be the most important	134	13
Don't know	62	6