FMS Update

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# Coming Clean on Overdraft

*Institutions work to shift customer, regulator perceptions*

**FOR the most part, it's hard to** find anybody outside of the banking industry with something nice to say about overdraft protection.

With the Consumer Financial Protection Bureau (CFPB) long beating the drum for some type of reform, most takes on the topic continue to run along the lines of a recent *New York Times* article focusing on consumers racking up big charges while banks laugh all the way to, well, themselves with a pile of big fees.

While few institutions will dispute the notion that overdraft does, in fact, represent a solid (if not spectacular) source of noninterest income in an environment where every such dollar matters, recent data suggests that the service offers as much of a benefit to the consumers who use it as it does to the institutions that provide it. Even the CFPB may be considering a change of heart on overdraft, having removed it as a line item from its most recent list of regulatory priorities for 2016.

So how should community institutions view their overdraft programs in the current environment? Has the storm mostly passed, or is this merely a pause in the march toward the ultimate, inevitable demise of overdraft?

## Staying Power

Jeffrey Harper, President of BSG Financial Group in Louisville, Ky., believes that despite all of the uncertainty surrounding them, there are a number of reasons why institutions should not abandon discretionary overdraft programs at this point.

"Consumers still have short-term liquidity needs, and many of those needs are being met by these discretionary overdraft programs," Harper explains. "A lot of overdrafts are only outstanding between five and ten business days, so there is a need for short-term liquidity and community banks and credit unions are the best places to fill that need, either through a loan or an overdraft."

For those institutions opting to maintain a formal overdraft program, Harper says all of the regulatory attention these days means that rigorous attention to proper procedures and correct reporting should be an essential piece of the puzzle.

"It's more important than ever to be able to track things like who's overdrawing, the fees being paid for overdraft and the repayment capacity ratio – which is fees paid for overdraft divided by the amount of deposits made by that customer," Harper says. "A lot of institutions don't really know where overdrafts are being created, so a formal overdraft solution should be able to identify where those are occurring. This helps create a better service, but also shows regulators that the institution knows where its customers' needs are for short-term liquidity and how it's meeting them."

## Focus on Service

Harper believes that the key for institutions trying to change both regulator and consumer perceptions is to treat overdraft programs as the much-needed service that they are, and not just a fee-generating exercise.

"I think it's a pretty common mistake on the consumer side to not focus on overdraft service as a line of business," he says. "It's a line item that creates money for the institution, but they're not really focusing on it from a service perspective. A lot of times consumers will see the opt-in/ opt-out decision as little more than the fee, and they'll likely opt out because of that. They don't see overdraft as a service, because the institution doesn't really present it as such – it's more of a penalty to be avoided."

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One way that institutions may be moving in the right direction on this front is by transitioning from one-size-fits-all fixed-limit overdraft program to more of a dynamic- limit approach, where overdraft limits are set by multiple different attributes, such as deposits, frequency of deposits, deposit dollar amounts or length of relationship with the institution. Harper believes that this type of shift to a more automated, consistent and service- focused decision is a step in the right direction.

"More institutions should be moving toward the dynamic-limit approach, and treating customers as individuals rather than 'product types.'"

### Regulatory Concerns

While more institutions may be moving toward these types of customer-focused changes to their overdraft programs, there remains concern throughout the industry that these efforts may be for naught if the CFPB renews its call for a major overdraft overhaul. Harper, however, believes that any eventual regulatory intervention will likely be focused on tweaking current practices rather than doing away with overdraft altogether.

"As long as there are institutions, checking accounts and humans, there are going to be overdrafts," he says. "So overdraft isn't going to go away, but what may come to pass is some type of cap on the fees that can be charged on an annual basis. The regulators may also try to focus on alternative products. For example, if you have a customer who has had a certain number of overdrafts in a 12-month period, what other affordable solutions can you offer to that person?"

The determining factor in the CFPB's decision may ultimately be the agency's increased awareness about who exactly is using overdraft programs and why, as laid out in a number of recent studies.

"We're hearing something may come down in late 2017, but what we think is that the CFPB is getting more data and understanding who the overdraft users really are," Harper says. "It's not necessarily the poor, as many people assumed for a long time. The data shows that people who overdraft ten or more times in a given year are those whose monthly deposits range from $3,500 to $6,000. They don't have a higher collective balance but they deposit more, so it's all about cash flow and the lifestyle that overdrafters live. They're paying for the convenience value of their money." ■