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The state considers letting some banks charge more for bounce protection on checking transactions

BY SUSAN HARRIGAN

About a year ago, Peter Maffei, then living in New Hyde Park, noticed that more than $150 in fees had been deducted from his bank account. It turned out, Maffei said in a recent interview, that his balance hadn't been up-to-date when he checked it at an automated teller machine, and that he therefore had accidentally overdrawn his account with several debit card transactions and ATM withdrawals.

Compounding Maffei's surprise, his bank had sent payment to the merchants involved in the debit card transactions and then charged him the fees under a so-called "bounce protection" plan that he'd never asked for.

"I didn't know I had it until I got all these fees," said Maffei, 25, who now lives in Woodside and works as a chef. "It almost felt like I was being robbed."

Overdrawing an account - easy to do in this age of instantaneous electronic payments - could soon become more costly for many New York State residents. On Thursday, the State Banking Board is scheduled to vote on a proposal that would allow state-chartered banks to charge higher fees than they already do for bounce protection, a service that bankers say protects customers from embarrassment and returned-check charges, but which consumer advocates call a form of predatory lending.

A bank that offers bounce protection usually - but not always - covers the amount of an overdraft. In return for doing so, it charges a fee of $20 to $35 per overdraft, and deducts that sum, along with the amount of the overdraft, from the customer's next deposit. The fees can mount up quickly because overdraft notices are sent by mail, and until they arrive people may unknowingly use their debit cards, which are now promoted by banks for even the smallest transactions.

In addition to per-transaction overdraft fees, federally chartered banks often charge daily fees that can range as high as $11 as long as an account remains out of balance. But New York State-chartered banks have charged relatively small daily fees, or none at all, because state banking rules have treated such fees as interest, which is capped at an annualized 16 percent by the state's usury law. By contrast, federal regulators ruled in 2004 that federally chartered banks' bounce protection programs were not loans, and didn't place any significant restrictions on them.

Reasons for a change

The rule change that the Banking Board will consider Thursday would end the disparity between federal and state banks and allow state-chartered banks to impose any daily charges they wish on top of per-transaction charges. The action was requested by the New York Bankers Association, a trade group, on grounds that to be competitive, state-chartered banks need to be able to offer the same services as federally chartered institutions operating in New York. At an October hearing in Manhattan, Michael Smith, the association's president, said that the ability to charge higher fees also would deter overdrafts and "encourage careful account management" by consumers.

But consumer advocates say bounce protection programs, which banks also call "courtesy overdraft" programs, really encourage people to overdraw. They say that if state Banking Superintendent Diana Taylor proposes to let the state's banks make these programs more profitable, she should come up with consumer safeguards - something Taylor said she plans to propose to the Banking Board Thursday.

"It's not about courtesy, and it's not about protection," Sarah Ludwig, co-director of NewYork City's Neighborhood Economic Development Advocacy Project, said of bounce protection. "It's an extremely lucrative product that banks have figured out they can make tons and tons of money on."

Taylor, who is reportedly under White House consideration to become the next head of the Federal Deposit Insurance Corp., said that federal regulators' decision that bounce protection programs don't have to be treated as a form of lending creates a difficult situation in New York. Many federal banks are operating in the state, and state banks can apply to change their charters to federal ones if they wish.

"We need to be able to allow our (state) banks to offer sort of comparable products," she said, "because otherwise, we're going to lose (the ability to regulate) them entirely."

The state banking department, which gets income for its operations from assessments on banks, lost about 30 percent of its revenue in 2003 when the two largest banking companies it oversaw - J.P. Morgan Chase and HSBC Holdings - switched from state to federal charters. Taylor said the lost revenue wasn't a factor in her decision to support higher daily fees.

Currently, there are 56 federally chartered banks operating in New York, and 119 that have state charters, including seven headquartered on Long Island. Because the federally chartered institutions include some of the nation's biggest banks, they account for more than 60 percent of the state's banking assets.

In a February 2005 report, Howard Mason, an analyst with Sanford Bernstein, an investment research and management firm, estimated that bounce protection programs were generating as much as $9 billion in fees per year.

The programs became popular with bankers in recent years amid a general industry effort to reduce its dependence on income from the interest charged on loans.

"There's an increased reliance (by banks) on fee income" for profits because "it smoothes out the peaks and valleys that are inherent with interest income," said Greg McBride, an analyst for Bankrate.com. "There's been a pretty volatile interest environment over the past ten years."

Costs of bounce protection

To be sure, consumers whose credit record is good have long been able to make sure their checks don't bounce by asking their bank to link their checking account to a savings account, prearranged line of credit, or credit card. But bounce protection is different in that it is granted automatically to customers who don't ask for it, often in connection with "free" checking programs aimed at students and people with lower incomes. People may not know they have it unless they read the fine print in their account agreement.

Consumer advocates estimate that even without counting daily fees, bounce protection costs five times more than using a line of credit, and four times more than a pre-arranged transfer from savings. And if banks were required to disclose the fees as an annual percentage rate of interest on the amount of an overdraft, their figures would translate into APRs of several hundred percent, or even thousands of percent. For instance, a one-time $20 bounce-protection fee on a $100 overdraft that wasn't paid back to the bank for two weeks amounts to an APR of 520 percent.

The fees, the advocates say, can trap vulnerable people in a cycle of debt. At the October hearing, New Yorkers for Responsible Lending, a coalition of community groups, described what it said are a number of New Yorkers who are suffering because of bounce protection. Among them:

A deaf Brooklyn man who lives on monthly benefits of $666 from Supplemental Security Income, a federal program to help people with disabilities and the elderly poor. The man was charged more than $200 a month in bounce protection fees for overdrafts of $20 or $30 using ATMs. And because the bank deducted the fees when he deposited his SSI check at the beginning of each month, he would run out of money by the middle of the month and have to rely on more overdrafts to cover his living expenses.

A disabled veteran in upstate New York who mistakenly wrote a check for $12.50, even though he had only $3.78 in his account. The bank charged the man an initial $39 fee and then a $33 fee every three days until the time his next SSI check was deposited.

Clear descriptions needed

Taylor said that at Thursday's meeting she plans to propose requiring state banks to disclose the existence of bounce protection when customers open an account, and to describe clearly how the program operates.

"My philosophy is people have to know what it is that they're getting into," she said. "Then they should be able to buy whatever they want."

Taylor said she will suggest other consumer protections, as well, including a requirement that ATMs carry a warning when withdrawals might be about to expose people to overdraft fees. But she won't propose warnings when debit card transactions may cause an overdraft. "That's really difficult from a technical point of view," she explained because of the way such transactions are processed.

That lack of warning would disappoint Steven Petito of West Islip, whose daughter, Valerie, accidentally overdrew her account when she used her debit card twice last spring to buy gas and a pack of gum at a gas station, and then a few small items at a 7-Eleven. Valerie, 19, didn't have bounce protection but was charged her bank's "insufficient funds" fee of $32 per bounced transaction, or a total of $64.

Like Maffei, Valerie Petito said that prior to using the card she had checked her account balance at an ATM and it turned out to be wrong. She said it took days for the bank's notification of the overdrafts to reach her by mail. "Imagine if I'd made five" debit card purchases, she said.

The debate over bounce protection, Taylor said, "has been a really thorny issue because both sides are right.

"Consumer groups are right to say that bank shouldn't be allowed to charge for things when people don't know what they're getting. . . . On the other hand, this is a service, and banks have to be allowed to provide services and be able to make some money doing it."

Bounce protection "is a service that people want," Taylor said. "If consumer groups were to get a law passed stating that nobody was allowed to provide bounce protection, I think there would be a lot of screaming."

Don’t feed banks those fees

The Federal Reserve suggests several ways to keep from overdrafting your account and running up fees:

Record all checks when you write them, and also your ATM withdrawals, debit card purchases and online payments. Don't forget to include any fees.

Don't forget that you may have set up automatic billing payment for utilities, insurance or loans.

When you check your account balance, remember that some checks and automatic payments may not have cleared. Also, be sure to find out how much of your balance includes funds that would be available through "bounce protection" plans, also called "courtesy overdraft-protection." Some ATMs actually show that amount as part of your balance.

Go over your account statements every month.

Consider ways of covering overdrafts that may be less expensive than bounce protection, such as linking your checking account to a savings account, an overdraft line of credit or a credit card you have with the bank.

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Average fees nationwide for transactions that are allowed to bounce have risen more than $5 since 1998, according to Bankrate.com.

$21.57

Fall 1998

$26.90

Fall 2005