

Is Overdraft and NSF Income at a Tipping Point?

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Many things in life are subject to recalibration and reconsideration. For some of us, the run that used to be an easy jog in your twenties is difficult in your thirties, painful in your forties, and unthinkable by fifty. When you grow older, your perspectives on things might change from what they were in your salad days. As life wears on, you evolve.

Bank products and services also have a life cycle of their own. And sometimes they too exhibit an evolution in practice and in philosophy. Case in point: the banking industry's fascination with, reliance on, and potential reconsideration of overdraft and non-sufficient funds (NSF) income.

Like all life stories, we should start at the beginning to gain understanding of the basics. If a depositor draws an item (like a check) against their deposit account when there are insufficient funds to cover the item, the bank on which the item is drawn has a choice: It can return the item unpaid or alternatively, the bank can make an accommodation to its depositor and pay the item. If the bank chooses to pay the item, the depositor's account is considered overdrawn.

Banks have made this type of decision for hundreds of years - some historians trace bank overdraft practices back to overdraft accommodations provided by the Royal Bank of Scotland to one of its customers in 1728. In the US, these decisions were initially made at the branch level, often by the branch manager. While it hard to remember for some of us, depositors used to make regular trips to their local branch to cash paychecks, make withdrawals and so on. Through these frequent visits, branch personnel became familiar with their depositors' banking habits. Armed with this familiarity, branch personnel could gauge the risk of whether an overdraft on an account would be repaid quickly, or at all. If so, it would make an accommodation and honor the item. However, if the risk was too great the item would be returned. In both cases the depositor would be assessed a fee: a "NSF charge" if the item is returned unpaid, or an "overdraft charge" if it was honored and created an overdraft. These fees were aimed at dissuading the depositor from "bouncing checks" in the future.

It was a simple approach for a simpler time. But it didn't last. With improving technology, banks began to transform this one-off, decentralized decision-making process. In the name of speed and consistency, the "pay or return" decision became centralized and automated. And fees that were initially assessed to discourage shoddy deposit account management became a revenue stream. Profits followed.

Once the modern groundwork was laid, the fine-tuning began. Tweaks were made to the order in which items were considered for payment, in many cases to maximize the number of "bounced" items and the resulting fee income. Consumer use of checks declining? Include debit card transactions in the mix. And as interest rates on loans generally declined through the 1990s and much of the 2000s, banks marched the amount of overdraft and NSF fees upward. The unsurprising result: by 2019 overdraft and NSF charges accounted for nearly two-thirds of bank fee revenue by 2019, according to CFPB studies.

As this revenue stream grew, so too did consumer dissatisfaction and regulator concern. Litigation, supervisory guidance and ultimately regulation followed. This culminated in revisions to Regulation DD (the Truth in Savings Act regulation) to require advertising and periodic statement disclosure requirements, and new requirements in Regulation E (the Electronic Fund Transfer Act regulation) to prohibit assessing fees in connection with ATM and one-time debit card transaction overdrafts unless consumer opt-in to overdraft services for such transactions.

More recently, in a February 2022 request for public comment, the CFPB has also begun to take aim at charges it considers to be "junk fees." It considers such charges to be "mandatory or quasi-mandatory fees added at some point in the transaction after a consumer has chosen the product or service based on a front-end price...." The CFPB's concern with such fees is two-fold: First, because the fee is imposed as a surprise on the "back-end" of a transaction it prevents consumers from making informed price-based decisions about a product or service. And second, the amount of such fees far exceeds the marginal cost of the service they purport to cover.

The CFPB's junk fee initiative has grown significantly since this request for public comment. The CFPB web site now includes a Junk Fees Page discussing the agency's findings and initiatives across several financial products and services. Included on this page is CFPB Guidance on Illegal Deposit Account Junk Fees and CFPB Circular 2022-06 which takes at aim at "surprise overdraft fee assessment practices." Such practices involve a depositor having sufficient funds available in his/her account when a transaction is initiated or authorized, but insufficient funds when it later settles resulting in the assessment of an overdraft charge.

The best example of such "authorize positive / settle negative" transactions is a debit card transaction that is authorized at the point of sale but, due to intervening transactions and payment system lag, settles against insufficient funds. The CFBP is concerned that this confluence of factors makes it impossible for a depositor to reasonably anticipate and avoid the assessment of such a fee, making them "unfair" and in violation of the Consumer Financial Protection Act (CFPA). This circular was sandwiched between two consent orders against large banks (one in September and another in December of 2022) that found authorize positive / settle negative practices to be an unfair (and in one of the consent orders an "abusive") act or practice in violation of the CFPA.

Further regulation on the overdraft and NSF front may also be on the horizon. Twice a

year the CFPB publishes its [rulemaking agenda](#), alerting the industry of what might be coming down the road. The [Fall 2022 Rule List](#) includes two items of particular interest. The first is a note indicating that the CFPB may be [considering amendments to Reg Z's treatment of deposit overdrafts](#), and the second notes that the CFPB is [considering rules regarding NSF charges](#). Both are in the pre-rule stage, so specifics on what these might entail are scarce. Both should be monitored going forward.

To its credit, the industry at large has not remained monolithic and stagnant in its treatment of these fees. Indeed, the CFPB noted in a series of blog posts in [February 2022](#), [April 2022](#), and [July 2022](#) that a number of large institutions had modified their overdraft practices to reduce overdraft fees amounts, capping the number that could be assessed in day, and increasing the "de minimis" thresholds (before an overdraft is charged) and "grace periods" (a period a depositor has to bring an account positive before assessment of an overdraft fee). These posts also acknowledge that an increasing number of institutions are eliminating OD and/or NSF charges. Indeed, the CFPB created (and has periodically updated) a ["Top 20 Overdraft / NSF Metrics Chart"](#) as scorecard for the evolution of these fees.

Where in the life cycle of overdraft and NSF fee income the industry might be is ultimately unclear. However, the tea leaves seem to indicate that - either by virtue of regulation, maturation, or perhaps both - some larger institutions are recalibrating their views and dependence on this revenue stream. Whether it continues, and whether it spreads to other market segments (e.g., we have heard that some small community banks are eliminating NSF fees), will be interesting to witness.

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