



CHUCK JAFFE

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Overdraft fees protect the bank, not you

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By **Chuck Jaffe**, MarketWatch

BOSTON (MarketWatch) -- I stopped in at my bank this week, and the woman in line ahead of me was a friend of mine. The teller was finishing up with her transaction when she reminded my friend that her account no longer had debit-card overdraft protection.

My friend was a bit taken aback, protesting that she doesn't overdraw the account.

The teller explained this had nothing to do with the woman's checking activity, and everything to do with new laws. Every checking account that had automatic overdraft protection lost it on Aug. 15, unless the account holder opted to keep the protection.

"So I've always had it -- even if I never used it -- and now I don't?" my friend asked. "And it's not going to cost me anything?"

'Vultures' save troubled homeowners

Some investment funds are emerging as the best hope for millions of U.S. households, like the Reynolds, above, who were behind on their mortgage payments.

The teller answered yes to both questions, and produced the paperwork

to opt in, a form that requires little more than an account number and signature.

And then my friend asked the fateful question: "Hey Chuck, what should I do?"

The quick answer was "Step aside, there are other people waiting." The longer answer is that the Federal Reserve did you a favor by taking overdraft protection off of your debit card.

Somehow, my friend managed to miss the build-up to the removal of automatic protection, which is hard to believe given that the same bank was constantly bugging me over every one of my family's accounts. The good news is that, because she has never overdrawn her account it was much ado about a problem she never faced.

That's the way it is for most banking customers, which is precisely why consumers often opt out of overdraft protection when they learn more about their options. To see why that is, let's review the situation and the rules.

For years, as debit cards became more popular, many financial institutions allowed overdrafts on withdrawals at automatic teller machines and point-of-sale purchases. It was a "free service" -- meaning you didn't pay to have the protection -- right up to the point where you triggered it.

At that point, someone presenting their debit card against insufficient funds would see the bank make good on the deal, but then tack on a fee of up to \$40 per transaction, putting the account holder deeper in the hole. The amount of fees that can be applied in these situations is unlimited, so someone using a debit card heavily can wind up in deep trouble fast. (The new Fed rules apply to debit-card transactions only; checking accounts can still carry overdraft protection, without the customer's advance consent, to cover insufficient funds.)

Remember, too, that the fees typically are charged per use, rather than dollar amount. A \$10 run to the convenience store to pick up ice cream could wind up costing about \$40 or more. At that clip, pay-day advance loans -- one of the most-expensive and problematic forms of lending -- look like a good deal.

In 2009 alone, banks collected \$38.5 billion in debit-card overdraft fees, according to

Moebs Services, a Chicago-based bank-industry consulting firm.

The Fed's new rules went into effect July 1 for new accounts and Aug. 15 for existing customers. The rules require that customers proactively step up and agree to the overdraft protection. If you don't opt in, or don't arrange for one of your accounts to back up another, and then you try to use your card against an inadequate balance, the purchase or withdrawal will be declined.

No purchase -- and no fees

For most people, that's actually good. An overdraft is typically taking a small problem -- a cash crunch -- and turning it into a bigger one.

Credit counselors talk about "serial overdrafters" -- people who are constantly going into the red to make purchases -- who say they are making legitimate purchases because they need to buy medicine or groceries. While there's no denying necessities, these same people presumably found some way to get by in the days before they had costly overdraft protection.

The banking community has suggestions for why consumers need overdraft coverage. You get the picture: You're traveling, thousands of miles from home, your child is sick, it's past midnight, and your card is declined at the all-night pharmacy.

Ugly, sure, but unlikely. Most families have credit cards; you may not like running up debt, but it would be cheaper to use the credit card than to pay fees on the debit card.

The same goes for virtually every scenario painted for taking overdraft protection.

The reasons for opting out, however, involve much more common financial situations. Many people overdraw an account accidentally, forgetting to put some withdrawal in their checkbook ledger (if they keep one), or failing to keep enough on hand when some automatic monthly payment comes due.

That said, when these customers overdraw their account, they aren't notified immediately. They can pile on the charges before they know what has happened.

Having the card denied, while momentarily embarrassing, is a good notice that there's a problem in the account. It's going to get the average consumer to go home and figure out what went wrong. That makes it a tool for fighting everything from identity theft to lazy account recordkeeping.

And setting up overdraft protection where a savings account backstops the checking account is easy. Moreover, when there are fees, they are more in the \$5 or \$10 range, a lot cheaper.

Like I told my friend, automatic overdraft protection on debit cards is always good for the bank, almost never good for the customer. If you haven't yet opted in, don't change your mind now just because your bank is pushing for it. ■

Chuck Jaffe is a senior MarketWatch columnist. His work appears in many U.S. newspapers.

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