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Community Financial Services Association of America

Study on Interest Rates of Overdraft Protection/ Bounced Check Loans Finds Median Implicit Interest Rate is 4,547% APR

“Hidden Consumer Loans: An Analysis of Implicit Interest Rates on Bounced Checks,” by Mark A. Fusaro, Department of Economics, East Carolina University, finds “the median interest rate on bounce protection loans to be in excess of twenty times that of payday loans.”

Fusaro concludes, “Payday lending attracts attention for its high interest rates, but bounce protection loans are much more expensive. When the amount borrowed is low and the time outstanding is short, the effective interest rate paid on this loan can be quite high.”

For the study, Fusaro examined 1,399 bank account transaction records from a small bank in the Midwest. The average account holder was 47 years old and had an annual income of \$31,600. Using the data set of checking accounts, the author calculates the implicit interest rate implied by the fixed fee, the amount of the overdraft, and the length of time the overdraft is outstanding.

Using an extreme example, Fusaro writes, “A person who has a three dollar overdraft that is outstanding for one day pays an implicit interest rate of 260,245%.”

Grouping accounts into four categories, from “occasional” overdrafters” (less than 10 times per year) to “chronic” overdrafters (100 or more overdrafts per year), Fusaro found:

- Occasional overdrafters are paying an average of \$112 per year in overdraft fees. This does not include NSF fees paid on bounced checks, only paid overdrafts. Frequent and chronic overdrafters are spending \$1,280 and \$3,440 in annual overdraft fees.
- Occasional overdrafters’ check sizes average \$306 per overdraft while frequent and chronic overdrafters average \$101 and \$90 respectively.

Full report available online at <http://personal.ecu.edu/fusarom/fusarobpinterestrates.pdf>

Noted in the study:

- **Bounce protection loans are more expensive than payday loans**

“We find that frequent overdrafters can pay fees exceeding \$3,000 per year which implies an interest rate in excess of 1,700%. The median implicit interest rate is calculated to be 4,547%. People over 70 years old pay a median interest rate in excess of 7,000%, the most of any sub-group examined.”

- **Unlike payday lenders, banks do not disclose the APR of overdraft protection**

“Legally, these are not loans, so they do not have to comply with truth in lending regulations which require disclosure of an APR. Thus data on the cost of such loans is scarce.”

➤ **People of all income levels overdraft equally often**

“Although income is not an accurate predictor of an individual’s likelihood to overdraft, those with annual incomes over \$60,000 pay the lowest interest rate of any group examined, 1,542%.”

“Almost 57% of account holders have overdrafted at least once since opening their accounts.”

“On average, customers overdrafted 46.2 in the, on average, 10 years since opening their account. The distribution is skewed with 42 percent never overdrafting and a few outliers overdrafting several hundred times.”

“Overdrafters are skewed toward younger customers...We see this trend even though older account holders have had their accounts longer.”

➤ **Customers using bounced checks as personal loans account for twenty percent of overdrafts**

“Consumers use bounce check loans in two ways. First, they use it as a form of overdraft protection. When consumers make mistakes with their checking account, a bank with bounce protection often pays the check...alternatively, many consumers intentionally bounce checks as a way of providing themselves liquidity...the former accounts for 80% of overdrafts.”

“Clearly, bounce check loans are not a good source of short term debt...With annual fees totaling over \$3,000 and four digit interest rates, most frequent users pay quite heavily for the money that they borrow.”

➤ **Service charges are a profitable income source for banks**

“In absolute numbers the weighted average service charge income has grown from \$26 million to \$1.49 billion over the same time period [1984 to 2003]...Further, the period of growth from the late nineties extending into the 2000s coincides with bounce protections’ commencement. ”

“...one industry estimate is that 60% of service charge income comes from NSF fees.”

“Research shows that when a bank pays overdrafts, customers overdraft 50% more. This fact explains why banks have embraced bounce protection.”