Overdraft Programs: Moving Forward With Confidence and Caution

By Mike Potter

Over the past decade, bankers, regardless of charter, size, or market, have increasingly begun to formalize offering discretionary overdraft programs for their customers, often through third-party bounce protection providers.

Offering overdraft services of some sort is certainly not new. Historically, nearly every bank in the country has, on occasion, honored a customer's overdraft. But the process was often informal and inconsistent. For example, bankers might call a customer if they noticed that a check was going to bounce before putting the check through.

Now, however, the industry is increasingly turning to a far more consistent solution, and banks and customers are reaping the benefits of a significantly improved level of service. Nearly a quarter of all banks are now providing these types of enhanced discretionary services, or "overdraft privilege" programs, to their customers.

Why the Change?

This move toward offering overdraft privilege programs is being driven by two main factors.

First, the programmatic approach to offering overdraft services is relatively new. When Strunk & Associates first began offering overdraft privilege consulting 10 years ago, it became the first provider to offer this type of service.

Second, after several decades of offering overdraft lines of credit, most banks have experienced that less than 10 percent of their customer households use these services. Most customers are simply not willing to go through the application and approval process for something that they don't expect to ever need. As a result, when busy customers occasionally make a mistake, the financial results can be quite costly. Non-sufficient funds fees, late charges, over-limit fees, and merchant fees can add up to take a toll on the customer. The late fee on a mortgage payment alone can exceed $100.

In the past, some banks have shied away from discretionary overdraft programs because they felt offering such programs might encourage customers to write overdrafts. Most banks, however, now understand that charging the same fee usually charged for returning a check to help a customer with an occasional overdraft can be a huge win for the customer, while providing an opportunity to educate customers about how to better manage their finances.

At Mutual Federal Savings Bank of Plymouth County in Whitman, Mass., offering overdraft privilege "has not only streamlined the daily workflow, but has made the decision process easier," said Richard Spencer, treasurer of the $107 million-asset bank.

"The customer acceptance has been terrific," Spencer said. "They understand very quickly that they were charged but that the check was paid—which saves them money and embarrassment. No doubt in my mind, this is a win-win service."

If your bank currently pays even an occasional overdraft, for any reason, these new guidelines contain new regulatory burdens of which you need to be aware.

Florence Savings Bank in Florence, Mass., also offers customers overdraft privilege. Making the transition from viewing NSF fees as a punishment to charging the same fee to facilitate an occasional and inadvertent overdraft fee as a privilege can be a powerful experience for the bank and the customer, said Nancy Bigda-Parent, operations director and vice president of the $753 million-asset bank.

"We made the decision to move forward with the Overdraft Privilege product because it was beneficial for both our customers and the bank. FSB was a 'return all' bank, and although we prided ourselves on being very customer-centric, we didn't really understand how heavily impacted our customers were by third-party fees," Bigda-Parent said.

"Since implementing this service, we have received numerous compliments from our customers because we were there for them when they needed us," Bigda-Parent added. "Our fee income has increased substantially, not at the expense of our customers, but rather as a result of the increased convenience for our customers."

Regulatory Developments

Bankers have had programs like Strunk & Associates Overdraft Privilege on their radar screens for several years. Over the past decade, Strunk has worked with almost one thousand financial institutions around the country.

Still, many bankers remain unconvinced that a discretionary overdraft service is right for them. But a better way to think about this question is: "Is the service right for the customer?"

The traditional way banks have addressed NSF fees and overdrafts has been to use the fees as a means of punishing the very customers that may simply need some help in better managing their finances.

Several factors are aligning to move increasing numbers of banks "off of the fence" in their consideration of the service.

First, following several highly profitable years for banks—as measured by industry return on assets—banks are now facing increasing margin pressures. As banks are forced to give away services such as online banking and bill-pay services, they need to strengthen other sources of revenue, and fee income becomes ever more critical.

Second, the long-awaited federal guidelines on overdraft programs may now be providing bankers more comfort in offering such programs.

However, the proposed regulatory guidelines are also cause for the "caution" mentioned in the title of this article. While there is nothing in the guidelines that prevents bankers from offering programs like Strunk's Overdraft Privilege, there are issues raised for any bank that honors overdrafts, regardless of how formalized.

In the proposed Interagency Guidance on Overdraft protection, the federal banking agencies made little or no distinction between newer types of discretionary overdraft programs and the services long offered by every bank in the country.

If your bank currently pays even an occasional overdraft, for any reason, these new guidelines contain new regulatory burdens of which you need to be aware. In a companion proposal, the Federal Reserve has proposed new disclosures under the Truth in Savings Act.

Strunk has strongly recommended that banks familiarize themselves with the proposed guidelines and Strunk's detailed analysis and comment to the regulators, as well as considering offering their feedback and comments to the regulators regarding these new regulatory burdens that will affect all banks.

This information can be accessed at *www.strunklp.com.*

All opinions expressed in this article are solely those of the author. Potter is regional vice president with Strunk & Associates L.P., an ACB Business Partner.

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