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It’s Time To End Overdraft Fees (And Chase Bank Is Just The Bank To Do It)

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Observations from the Fintech Snark Tank

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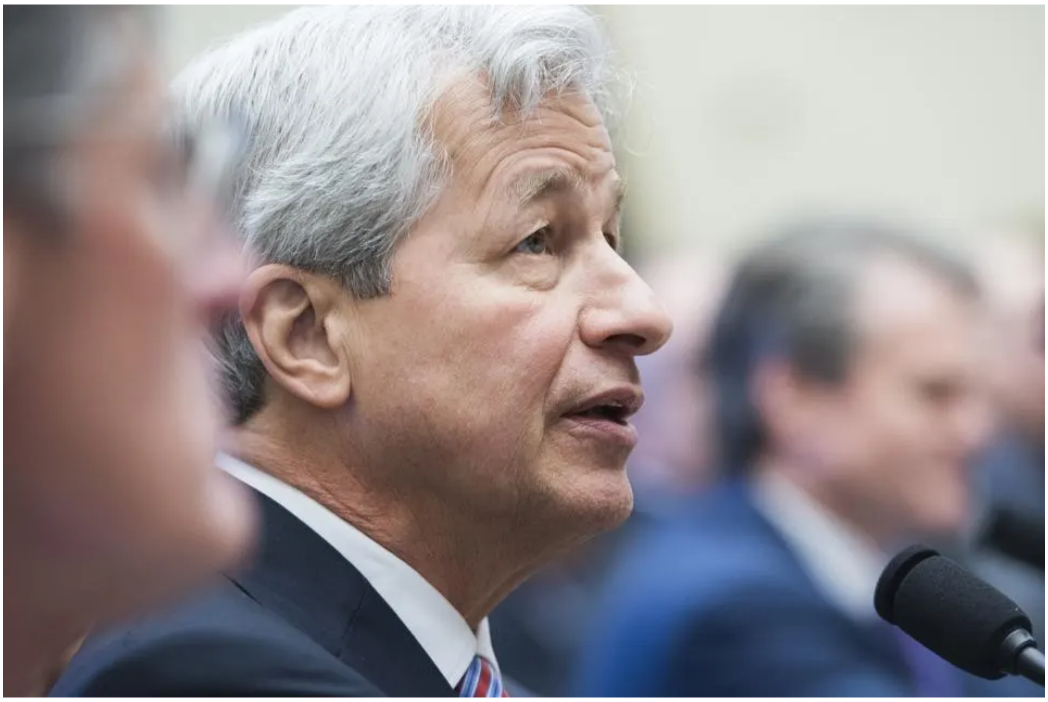

Jamie Dimon, CEO of JPMorgan Chase (Photo By Tom Williams/CQ Roll Call) CQ-ROLL CALL, INC VIA GETTY IMAGES

OBSERVATIONS FROM THE FINTECH SNARK TANK

Ally Bank, a $180 billion (assets) online bank announced that it would no longer charge its customers an overdraft fee. According to a report in the Wall Street Journal:

"Customers who overdraw their accounts will no longer face a $25 penalty. The change applies to the roughly 3.6 million checking, savings and money-market accounts at Ally's online bank. Typically, Ally charged for each day that a customer tried to buy something when their account was more than $10 in the red, except on debit-card transactions."

The move may not be as magnanimous as it sounds as overdraft fees accounted for just a James Bond-ish 0.07% of Ally's revenue in 2020, and the bank has never charged overdraft penalties on debit transactions.

In response to the news, Aaron Klein, a Senior Fellow in economic studies at the Brookings Institution, tweeted:

Aaron Klein
@Aarondklein · Follow

Excited to read that @allyfinancial eliminating overdraft fees. This is leadership other banks and credit unions should follow.

wsj.com
Overdraft Fees Are Getting the Boot at Ally Financial

6:32 PM · Jun 2, 2021

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Will Other Banks Follow Ally Bank's Lead?

Andrei Cherny, CEO of challenger bank Aspiration believes other banks *will* follow:

"We may look back at the announcement that Ally *will stop charging overdraft fees as the close of the last decade of fintech innovation: Fintech 1.0.*

Coming out of the 2008 meltdown, companies like Simple, Wealthfront, Betterment, SoFi sought to make financial services cheaper, faster, and fairer. They were soon joined by innovators like Chime, Acorns, and Robinhood.

They won.

Schwab and others saw robo-advisors offering asset management at 25 basis points and copied them (and raised them) by doing it for free. Vanguard and Fidelity waved the white flag on no-fee trading.

And now we are seeing the victory of the first neobanks as banks are dropping egregious fees on overdrafts and ATMs and adopting popular features such as round ups for savings and early pay days."

I want to agree with Cherny, but I'm not so sure. Here's my take:

Banks and credit unions will wait and see who else eliminates overdraft fees. If nobody blinks, the issue goes away. But if a few make the move, there will be a

rush, because no one will want to be the last financial institution with overdraft fees.

The Case for Keeping Overdraft Fees

Not everyone agrees with my assessment. According to Peter Dugas, Executive Director at Capco, and a former Deputy Assistant Secretary at the US Department of the Treasury:

"There will not be a rush since most of these banks and credit unions are not supervised by the CFPB and will not get any political pressure to do so. The only real option for a bank or credit union is to decline the charge. If you make it more complicated, you risk running into fair lending issues when you can't explain why one person was charged a fee, or the charge was approved, and another was not."

Jeff Marsico, author of the book Squared Away: How Can Bankers Succeed as Economic First Responders, added:

"Free overdrafts equal free loans. In addition to declining the insufficient funds transaction, the bank could impose higher minimum balances to reduce the incidence of the embarrassing transaction decline. And another opportunity to parade big bank CEOs to a photo op hearing."

The Case For Eliminating Overdraft Fees

Dugas and Marsico make logical and rational arguments.

But we're not talking about an environment where rational, quantitative business decisions rule. We're in an environment where optics rule—i.e., an environment where reputation risk outweighs financial risk when it comes to making business decisions.

As Brett King, author of Bank 4.0, and executive chairman of challenger bank Moven, said in response to my tweet:

*"It's not about doing the right thing, it's about **being seen** to do the right thing."*

In a recent senate hearing, Sen. Elizabeth Warren (D., Mass.) criticized the big banks for collecting overdraft fees during the pandemic:

"This is about millions of families who in the last year saw interruptions to their paychecks and challenges with extra expenses. And these giant financial institutions had a chance to step up and help those families and not one of them did."

There are (at least) two problems with that statement. The giant financial institutions (Chase, Wells Fargo, Bank of America, and Citibank):

- **Did take steps to help those families.** The megabanks all waived fees, deferred payments, offered payment assistance, and provided other forms of relief according to the BillGo Bill Pay Relief hub.
- **Account for a disproportionately *lower* share of overdraft fees.** Overall, the industry charged more than $30 billion in overdraft fees in 2020. The megabanks took in roughly $4 billion—13% of the total. In terms of asset size, however, the megabanks total $8.7 trillion—40% of all US bank assets.

Four billion in revenue is a lot of money for the large banks to walk away from. And the fact of the matter is that what the others banks and credit unions charge is a lot of money to them.

There are, however, three reasons why it could make sense for one or more of the big banks to eliminate overdraft fees:

1) Competitive positioning. A move by any of the big banks to eliminate overdraft fees would cause a ripple effect. How could community banks and credit unions—who stake their claim on being "consumer-friendly" alternatives to the "big evil megabanks"—continue to charge these fees if the big banks eliminate them?

2) Value signaling. There's a social impact aspect of a decision to eliminate overdraft fees. As the Financial Health Network has pointed out, a high percentage of these fees are paid by Black American and Hispanic customers. Eliminating the fees sends a strong message about the banks' commitment to these underserved consumers.

3) Pre-empt regulatory action. The big banks squander any opportunity to benefit from points #1 and #2 if they wait until the regulatory powers-that-be regulate overdraft fees out of existence. You've got to believe that's what Democrats want to do, but haven't had a majority in a while to do it. They're not exactly dominant now, but with JPMorgan Chase indicating that it won't make political donations to a whole host of Republicans, there may be enough Republicans looking to punish Chase for that.

What Can (and Will) Banks Do?

Ketharaman Swaminathan of GTM360 captured an importance nuance in this discussion when he asked in the Twitter discussion:

"Does 'eliminate overdraft fees' mean 'eliminate overdraft itself' or 'free overdraft'?"

The banks don't actually have to eliminate overdraft altogether—they could offer a Chime-like "Spot Me" feature which enables some customers to "overdraw" by up to $200 with no fees.

Banking Dive reported that Huntington Bank has taken a stab at curbing overdraft fees with a line of credit product:

"Huntington Bank on Tuesday launched Standby Cash, a digital-only loan product the bank said will help customers avoid overdraft fees and build credit. Through Standby Cash, eligible customers are given immediate access to a line of credit up to $1,000 with no interest or fees if they sign up for automatic payments."

In the end, I stand by my tweet: Most banks and credit unions will sit and wait to see who else eliminates overdraft fees. I doubt anybody will blink. But Chase Bank *should* pull the plug on overdraft fees and force everybody else's hand on the matter.

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