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The Death of Overdraft Fees – What Now?

I recently published a blog post that talked generally about how people (including bankers) feel about paying fees. In researching that article, I came across two interesting articles that talk about the growing trend in banking of financial institutions (FIs) dramatically reducing or eliminating overdraft (OD) fees.

The first article can be found here - [The Beginning of the End for Overdraft Fees — What's Next? (thefinancialbrand.com)](). The article indicates that OD revenue has fallen 15% in the past decade. The article points out that overdrafts do not represent the manual effort they once did. Couple that with consumer awareness of what they perceive as "excessive" bank fees and the general optics of FIs taking advantage of customer's bad financial habits. While many FIs are already dramatically reducing their OD fees, legislation like the Overdraft Protection Act would limit FIs to 1 OD charge per monthly statement cycle AND no more than 6 ODs per year.

After temporarily suspending ODs during the peak of the pandemic, many FIs are seeking alternative options for dealing with overdrafts. In April of 2021, Frost Bank eliminated ODs on amounts of $100 or less. PNC now offers a "Low Cash Mode" that gives customers flexibility in what debits are posted in a 24 hour period, allowing for cash management to avoid an overdraft. Regions simply replaced OD fees with a $5 monthly fee, while enhancing balance alerts for customers. Others like Bank of America are offering credit lines up to $500 for a $5 fee, with a three month installment plan to pay it back.

Not to be outdone, Neobanks are aggressively targeting OD fees. Chime offers a "spot" credit of up to $200 to cover overdrafts, with the amount being deducted on the account holder's next payroll deposit date. And some like CapitalOne are allowing customers to access funds that are associated with payroll deposits early. Good and interesting ideas all.

Speaking of CapitalOne, the second article can be found here - [Why CapitalOne's Move Won't Be the Death of Overdraft Fees (thefinancialbrand.com)](). This article highlights the move by CapitalOne to eliminate all NSF / OD fees altogether, making them the largest institution to do so. More importantly, CapitalOne says it "does not plan to replace the lost revenue from overdraft fees in other places". This might be a new customer acquisition play as research from The Financial Brand from 2021 shows that 61% of consumers are "likely" or "very likely" to switch FIs in order to reduce or eliminate OD fees.

Not mentioned in either of these articles is the positive effect of overdrafts for customers who, either through an error, poor cash management or simply who have come up short in their deposits, need to have a debit covered. The financial institutions are paying these debits, regardless of whether it is for a $5 coffee. a $500 insurance premium or a $1,500 rent/mortgage payment. The bank is performing a service and it really doesn't have any guaranty that the overdraft will be covered (except when an overdraft protection service is in place. But even that loan can go unpaid.). Thus the true nature of overdraft fees is not recovery of the actual cost of processing but covering the risk of overdrafts that must be written off. Still this is a tough sell in an environment where activists are constantly beating the drum of the "evil bankers" that are trying to stick it to their customers.

All of this got me thinking about what kind of innovation could be brought to bear against OD fees in specific and bank fees in general. One of the main issues of customer dissatisfaction with fees stems from their perception that banking is "free". This is a problem we as an industry have fostered and it is now ingrained into the public's expectation of how banking services are charged. The basic free checking goes something like this: you get "free" checking, but there are a number of stipulations on the free component, such as maintaining a certain minimum balance throughout the entire statement period, having a direct deposit on that account, performing a minimum number of certain transactions OR not performing more than a maximum number of certain transactions (i.e., writing checks), and so forth. Inevitably, the customer misses one or more of these elements and incurs a Service Fee, which shows up on their statement, let's say for $8.95. There is no explanation for what caused this fee, it just appears. This causes confusion and resentment on the part of the account holder. And depending on any number of factors, if the customer complains about it, the fee will get reversed, further emphasizing that this was not a legitimate fee to begin with.

So how can we fix this? Well, here is one idea. Let's gamify the whole service fee process. I mean literally make it a game. First, before I share the details of the game, let me suggest that all of the future customers you need to replace super seniors and baby boomers are already ingrained in a gaming culture. But even older Gen X and younger baby boomers are gaming, I see it on every flight I take; a 50 something year-old playing Candy Crush or Clash of Clans. Trust me, it's a thing.

OK, here's the game. Each month, you charge EVERY account holder $8.95 per transaction account. They get a notice via text to check their mobile app and once they open the app, they see that the monthly charge for January has posted, $8.95. They can click on the circle "i" next to the amount and they will see a list of the many, many things your institution does for that fee. It is really a great deal. But the game is this: the customer has the rest of the statement period to get their fee to zero. That's right; the game turns the whole fee elements situation around and gives credit for all of the good behavior an FI wants. Does the customer keep over $500 every day in the cycle? Great, that is a $2.50 credit. Have Direct Deposit coming to this account? That is $2 credit. Maybe $.50 for each signature debit card transaction they perform. And so on. Every behavior that drives a revenue component for the FI can be tied to a credit to the customer for that behavior. All the way down to zero. And you would make a very big deal out the customer getting to zero. What a difference in the way an account holder "feels" about their institution versus punishing them for missing a required "free" element.

So what if they don't make it to zero? The choice is theirs. Did they go below $500 in this period? Then they don't get that $2.50 credit. Maybe their total service charge for January will be only $2.50. But I suspect you won't get angry phone calls because your mobile app is constantly updating them on their game status and the control over fee or no fee is in the customer's hands. And it would work for all fees. Did the customer have foreign ATM fees? Or an overdraft fee? Add these to the game and let them use their behavior to whittle them down. And you can encourage other behavior. Like the customer recommending your FI to a friend, who signs up for an account, which creates a $25 credit to the first customer's game account. There is literally no end of options for the game and this allows for changes in how services are priced and for what elements that are associated with credits.

Does this idea sound crazy to you? Perhaps it is. But I truly believe that one of the keys to the future of our industry is to get very serious about the level of innovation that will be needed in the coming years. Maybe you have other ideas about what innovations can be brought to bear on the issue of overdraft and other bank fees. Or you want to comment on my gamification idea. If so, reach out to me at dpeterson@bankers-bank.com and share your ideas.

Game on!