NASHVILLE NOTES

Bouncing checks

Wednesday, August 11, 2021 8:06 AM CT

By Jeff K. Davis

Jeff Davis CFA is a veteran bank analyst. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of S&P Global Market Intelligence; Mercer Capital, where he is the managing director of the financial institutions group; or StillPoint Capital, where he is a registered representative.

So far, the decision by Ally Financial Inc. to end consumer overdraft and insufficient funds fees has not caught on with U.S. banks for good reasons: consumers are supposed to be deterred from overdrawing accounts; banks incur credit costs from uncollected funds; and for many banks the fees are not immaterial. Commercial overdrafts that are paid occasionally can be a source of material losses, too.

Ally's move makes sense for it. Overdraft fees were less than $10 million compared to $8.28 billion of revenues for the 12-month period ended June 30, 2021. I suspect the move internally is viewed as a low-cost marketing expense with upside potential for the company's digital consumer bank. Deposits are plentiful and cheap today, but that will not always be the case as bank liquidity and loan demand are counter-cyclical.

Even if rates stay near zero for years to come, customer acquisition costs can be significant. Ally does not have the same type of legacy low-cost core deposit franchise as long-time commercial banks do, such as Bank of America Corp. Neither does Discover Financial Services, which also does not charge insufficient funds fees.

I am mildly surprised that overdraft fees have not gained as much traction as the movement to cancel student debt and moratorium on renter evictions. Because consumer overdraft fees are disproportionately paid by low- and moderate-income Americans, the issue may become part of the national discourse about income inequality. If so, banks could lose the issue in an environment where the public welfare is pitted against financial institutions. And on a more basic level, concepts such as contract law and property rights have less sway with the public today than in prior eras.

Sen. Elizabeth Warren is elevating the issue as she pushes bank regulators and the Biden administration to reduce the industry's leeway to charge overdraft fees. After a hearing during May on the issue in which JPMorgan Chase & Co. CEO Jamie Dimon was challenged (or hectored depending upon one's perspective), she said regulators should be much more aggressive in monitoring fee practices and later suggested that banks refund the fees.

Aaron Klein, a senior fellow at the Brookings Institution, argued in an opinion piece that regulators should reconsider whether an overdraft fee is really a loan, which has implications for usury given the fee ($25 to $35 typically), the duration of the overdraft (usually cured in a few days), and the amount of the overdraft.

The CFPB presumably would be central to any change in industry practices from a regulatory perspective, which in 2019 under the Trump administration took a look at easing the "opt in" rule that was adopted in 2010. The rule requires financial institutions to obtain a consumer's consent before charging a fee for paying ATM and one-time debit card transactions that overdraw the account.

The wind is now blowing from a different direction, as Sen. Warren has clearly articulated. The CFPB has more than a bully pulpit. Among the numerous and large fines it has levied in the past decade was one directed at TD Bank NA in 2019 that resulted in the bank paying $97 million of restitution to customers and $25 million of civil penalties regarding the marketing of its overdraft product.

Yet, I cannot help but think about my first job after college in 1985 when I joined AmSouth Bank, which is one of the large predecessor companies to Regions Financial Corp. By happenstance, I had been in Birmingham after graduating without a job. I met (or cornered) a director at a social event, and within a few weeks I was working in the corporate credit analyst program in Mobile, Ala.

I distinctly remember being told three things in the first few weeks of employment by the head of credit in what was then the Southern Region of AmSouth Bank.

One was the bank does not capitalize interest. That seems laughable today given how construction and sometimes other types of lending work. The second was that any borrower who cannot pay off their revolver for 30 consecutive days needs permanent capital and the bank was not in that business. I am sure there were exceptions, but he was emphatic. As an aside, Regions and most large regional banks now have robust corporate debt origination, distribution and trading capabilities because their corporate customers require it.

The other non-negotiable related to check writing. I was told point blank that if I bounced a check I would be fired. The threat stuck with me, in part, because as an undergraduate I bounced a few checks unintentionally by playing the float over a weekend. The fee I was charged was probably $10, which adjusted for inflation nearly 40 years later is in the vicinity of $35.

Management's (or maybe just my manager's) stance seemed harsh; however, banks and businesses have to have standards and deter behavior that is bad for the individual and society even if the penalty has evolved into a significant profit source for banks and a worthwhile convenience fee for overdrawn consumers.

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Published with permission. Jeff K. Davis, Managing Director of Mercer Capital's Financial Institutions Group, is a regular contributor to S&P Global Market Intelligence, formerly SNL Financial. He can be reached at jeffdavis@mercercapital.com or 615.345.0350.