EDITORIAL

Debit Card Trap

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Not many people would knowingly pay more than $35 for a cup of coffee. But far too many people are getting saddled — with no warning — with outsized bills for minor purchases, under a euphemistically labeled “overdraft protection program” that most major banks have adopted over the last 10 years.

Before that, most banks would simply have rejected debit transactions, without a fee, when the card holder’s account was empty. Now, they approve the purchase and tack on a hefty penalty for each transaction.

Moebs Services, a research company that has conducted studies for the government as well as some banks, reported recently that banks will earn more than $38 billion this year from overdraft and bounced-check fees. Moebs also estimates that 90 percent of that amount will be paid by the poorest 10 percent of the customer base.

Federal regulators who stood idly by while this system evolved are considering new overdraft rules that could provide more transparency. If they do not move quickly and aggressively to protect consumers, Congress should step in.

Banks have historically covered bad checks for valued clients, who were invited to opt in to overdraft protection or to link their checking accounts to savings accounts or to lines of credit. But as more people began to use debit cards, the banks started to view overdraft fees as a major profit center and started to automatically enroll debit card holders into an overdraft program. Some banks instituted a tiered penalty system, charging customers steadily higher fees as the overdrafts mount.

A study by the Center for Responsible Lending, a nonpartisan research and policy group, describes what it calls the “overdraft domino effect.” One college student whose bank records were analyzed by the center made seven small purchases including coffee and school supplies that totaled $16.55 and was hit with overdraft fees that totaled $245.

Some bankers claim the system benefits debit card users, allowing them to keep spending when they are out of money. But interest rate calculations tell a different story. Credit card companies, for example, were rightly criticized when some drove up interest rates to 30 percent or more. According to a 2008 study by the F.D.I.C., overdraft fees for debit cards can carry an annualized interest rate that exceeds 3,500 percent.

The banks, which have grown addicted to overdraft fees, will almost certainly resist new regulation in this area. But there are several things that federal regulators must do to protect the public.

First, banks must be barred from automatically enrolling customers in overdraft programs. This must be a service that customers opt in to — and only after they are provided full information about the fees and the penalties they will incur. These disclosure statements must meet the same rules laid out in truth-in-lending laws, since overdraft charges are essentially short-term loans.

Banks must also be required to warn customers in real time when a debit card charge will overdraw their accounts — and what fees they will incur if they still decide to proceed with the purchase.

This will require new technology. But there is almost no chance that the banks will invest in it unless they are legally required to do so. Until that happens, buyers beware. That cup of coffee may be even more expensive than you realize.

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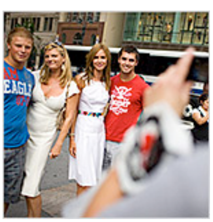

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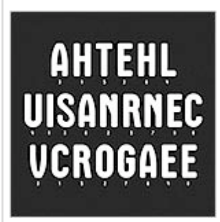

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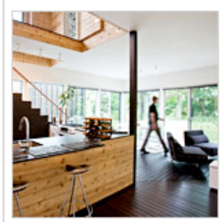

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