Who Pays the Price?
Overdraft Fee Ceilings and the Unbanked

by Dlugosz, Melzer, and Morgan

Discussion by Christopher Palmer
MIT Sloan & NBER

Boston Fed Day Ahead Conference
January 6, 2022

MIT MANAGEMENT SLOAN SCHOOL

Overdraft fees topic could not be more relevant

- Pending legislation: *Overdraft Protection Act*, *Stop Overdraft Profiteering Act*
- $15.5 bn in overdraft and non-sufficient funds fees in 2019 (CFPB, 2021)
- 2/3 of fee revenue. Worry much more than compensating for risk and costs
- 80% of fee revenue from 9% of customers w/ 10+ overdrafts/year (CFPB)
- 1/3 of unbanked households cite high fees as a reason (FDIC, 2020)
- Regulatory interest: shrouded attribute on multi-dimensional, sticky product makes it hard to fix with competition

- This paper: could capping overdraft fees backfire? Overdraft is credit. Increasing the cost of that credit could decrease its supply.

Summary

- Narrative: Several states already cap overdraft fees. OCC ruled in 2001 that national banks are exempt from state regulations. National banks then raised overdraft fees.
- Causal question: What effect did removing a cap on overdraft fees have on overdraft credit access, deposit access, and the likelihood of being unbanked?
- Strategy: Triple diff-in-diff comparing national vs. state banks, pre vs. post OCC ruling, in states with vs. without overdraft fee caps (Di Maggio and Kermani 2017)
- Price control imposition endogenous, aggregate removal exogenous
- Findings: Overdraft fees increase, overdraft credit increases, bounced checks decrease, required minimum deposits decrease, low-income % banked rises

Laudable data lift

- Standard deposit data sources lacks historical data on overdraft fees, unbanked prevalence
- Moebs Services annual telephone survey of 600 bank branches/year ask about overdraft availability, overdraft fees
- RateWatch data on checking account maintenance fees, min balances
- Fed Check Processing Centers in 35 states: bounced check counts
- SIPP panels for checking account ownership with state identifiers

Outline of Comments

1. Separating supply and demand-side interpretations
2. Bolstering identification argument
3. Suggestions for complementary research questions

Is the channel demand or supply?

Facts: when allowed to, national banks

a) increase overdraft fees
b) increase overdraft protection
c) decrease required minimum balances to avoid maintenance fees

<u>Supply-side interpretation</u>

overdraft fees ↑
→ cost of providing overdraft credit ↓
→ demand for overdraft protection ↑
→ adverse selection ↓
→ required minimums ↓

<u>Demand-side interpretation</u>

overdraft fees ↑
→ demand for accounts ↓
→ required minimums ↓
→ demand for accounts ↑

Separating supply and demand-side interpretations

Key questions:

- Was drop in required minimums to compensate consumers for increase in overdraft fees?
- Or was drop in required minimums a supply-side expansion of credit in response to a decline in the cost of providing that credit?

- Answers hinge on demand elasticities
- Demand-side story requires elastic demand w.r.t. overdraft fees

overdraft fees ↑

→ demand for accounts ↓
→ required minimums ↓
→ demand for accounts ↑

Lessons about deposit demand?

- If overdraft fees were the only thing that mattered to consumers (and if search costs were zero)
  ⇒ national banks wouldn't be able to increase fees after OCC exemption.
- Given that they did raise fees once unconstrained
  ⇒ consumers were **inelastic** w.r.t. overdraft fees
  (consistent with shrouded attributes)
- After all, if consumers were elastic w.r.t. overdraft fees, would have lowered overdraft fees below the caps to begin with.
- Given that national banks increased overdraft credit and lowered required minimums, means consumers were **elastic** w.r.t. overdraft protection and minimum balance requirements
- Supports supply-side interpretation

Easy supports to identification argument

- Show 4 time series by national/state banks and limit/not states for as far back as possible to judge whether diff-in-diff effect coming because of treatment or control
- If anything fishy, could show results with only smaller national banks as more comparable to state banks

- Own that the controls are there to strengthen the credibility of the results that can't look by national vs. state bank.
  - For example, the bounced checks results rely on 3 states, could easily face different time shocks, but unemployment rate and income controls should help lots
  - Show these results w/ and w/o controls and hopefully controls not mattering bolsters case that double diff-in-diff is sufficient.

Worthwhile adjacent questions

1. "Before opening a new checking account, [banks] review the applicant's debit score on a shared deposit registry."
   - News to me! Very interesting. Data access?
   - How much is this deposit registry used? How consequential? Regulated? How long do adverse events stay on registry? Discontinuities in deposit account approval rules as f(score)?
2. Are required minimum balances a form of credit rationing to mitigate adverse selection? Modern empirical test of Udell (1995)
3. How were state banks affected by this competition?
   - See Di Maggio, Kermani, and Korgaonkar (2019) race to the bottom
   - Window into how other banks might respond to Capital One getting rid of overdraft fees?

Conclusion

- Price ceilings can backfire and decrease the quantity and quality supplied.

- Overdraft price ceilings are no exception.
- After caps removed, prices go up, but so do overdraft supply, deposit supply ⇒ unbanked share decreases

- Yes, small share of consumers pay most fees, but deposit credit access is important for many low-income households.

Little comments

- Include banks that don't have an overdraft or NSF fee. Makes results more representative. Dropping non-overdraftable banks overstates effects of the policy.
- "fees at other banks in fee limit states declined significantly post exemption" I think this coefficient is actually just undoing the Post coefficient capturing the upward time trend in fees in unregulated states
- Normalize 2000 to 0 instead of 1999 so the confidence intervals relative to 0 are immediately informative
- Note in table notes that LPM coefficients are multiplied by 100