Are Fees Bad, Good Or Something Else?

by Steve Brown

We recently heard a humorous story from one of our employees about her banking experience when she was much younger. Her parents had opened a checking account for her with a local community bank and she excitedly began writing checks. Well, every now and then, she would get behind on balancing her checkbook and overdraft the account by a small amount. One day, an overdraft notice came to her house. Her mom, embarrassed by her daughter's lack of checkbook-balancing skills, told her daughter that because they had a good relationship with the bank, her daughter had to leave the bank. The mother was assuming, as many perhaps do, that the bank must hate the fact the daughter was always overdrawing the account. The daughter later entered the world of banking (after much improving on her math skills) and realized she was instead probably one of their favorite young customers. After all, they were making some money on the account.

This story took place many years ago, back when we would see ads for "totally free" checking accounts and product promotions designed to bring in deposit dollars and generate profitability from overdraft fees rather than monthly service fees. Customers did not want to pay monthly fees for an account, but were surprised by overdraft programs that, in the early stages, left no ability for a customer to opt out. Buying a coffee at Starbucks could cost someone a $30 overdraft fee back then if they didn't have enough money in the account to cover it.

During and after the credit crisis, there was a collective sense from Congress that these sorts of "protections" preyed on the people who could least afford to pay fees. Consumer protection regulations followed, outlawing such "questionable" practices and pushing them into the unbanked world. As a result, banks have experienced a significant decline in this kind of fee income over the past few years and many smaller retail customers and low-income individuals no longer have many options for banking services. Customers don't seem to understand that there is no such thing as a free lunch and banks can't afford to offer services like checking accounts for free if no other business follows.

We are intrigued by a solution Bank of America may be working on. It gets away from free checking with a new "checking" product (we put quotes around "checking" because there are no actual checks included with the account). The account is called SafeBalance and it is a transaction account with a debit card, web access and mobile banking. It also has no possibility of an overdraft or overdraft fees. By structure, if a payment is submitted and there is no money in the account, the payment is simply rejected. The account carries a monthly fee of $4.95 regardless of the balance and the fee cannot be waived.

Many consumer advocacy organizations have long asked for this type of setup from banks as they seek accounts where consumers can't create an adverse fee situation through their own oversight or negligence. We don't know how well this will work and can think of many scenarios where the consumer could be embarrassed due to a shortfall and a corresponding rejection.

People don't like to pay any fees, but it remains to be seen whether this product (with a low, predictable fee) will sell vs. an account with no set monthly fee (but the potential for much higher fees in the event of an overdraft). For customers with lower balances who are most likely to overdraft, this kind of predictability should be a welcome feature, but it will be interesting to see how the public responds. Will these customers miss the "protection" of being able to make a purchase when they are a few cents short or will they just walk away after the reject? Only time will tell.

BANK NEWS

M&A

NBT Bank ($7.6B, NY) has sold its 20% ownership interest in Springstone Financial to LendingClub for an undisclosed sum and entered into an agreement to participate in lending activities related to Springstone's financing operations.

M&A

First Financial Bank ($6.4B, OH) will acquire The Guernsey Bank ($123mm, OH) for $13.5mm in cash.

Branch Closures

U.S. Bank said it will close 13 branches in IL in Jun/Jul after its acquisition of Charter One closes.

Money Transmitters

FinCEN has clarified which business models are subject to restrictions on money transmitters under BSA indicating: companies offering escrow services and secured transactions in connection with online sales (not a money transmitter); companies renting computer systems used to mine virtual currencies (no); companies using armored cars to facilitate the exchange of coins and cash (does not qualify for armored car exemption, but also is not a money transmitter); company operating online payment platform facilitating deposits and settlements for banks, businesses or consumers (yes, is considered a money transmitter).

Fine

First Horizon National, the holding company for First Tennessee Bank ($23.6B, TN) will pay $110mm to the FHFA to settle allegations it sold faulty mortgages to FNMA and FHLMC.

Fine

The Wall Street Journal reports France's largest bank and parent company of First Hawaiian Bank & Bank of the West, BNP Paribas SA, is facing fines of around $2B and criminal charges related to violations of U.S. sanctions against various countries including Iran. The bank reportedly tried to cover up transactions and altered trades to hide their origin.