Is Your Overdraft Program a Black Box?

Ask yourself these 10 questions.

If your examiners asked, could you explain how your overdraft management program calculates overdraft limits?

It shouldn't be a mystery, but many overdraft programs make it one.

Once your system processes the data and sets a limit, you should be able to clearly outline that process, step by step. Better yet, if you understand the key factors, trends and overrides determining the limits, you can customize your overdraft program to provide standout service to your account holders.

Overdraft programs thrive on the wealth of data you already have, like consumer metrics, overdraft habits and trends—if you can access it. Ideally, you should be able to easily tap into that information to make smart decisions about managing your program. Unfortunately, many overdraft solutions only offer rigid, pre-built reports and upcharge for special queries, leaving you in the dark about your own program. Worse, they often rely on opaque pre-set formulas to calculate overdraft limits, hidden from you.

That makes your overdraft program a black box.

With fairness in overdraft practices under scrutiny today, banks and credit unions need a system that manages risk appropriately for both the financial institution and the account holder, while also setting reasonable overdraft limits so consumers don't dig themselves into a hole they can't escape.

Is your overdraft program a black box? Ask yourself the following questions:

1. Do you know how to turn data into actionable information?

If your answer is "no" to any of these questions, chances are your overdraft data probably isn't working as hard as it could for you.

- Are all the factors determining limits visible to you (along with their weights)?
- Can you track each account's fees-to-deposit ratio? If an account holder pays 25-30% of their deposits in fees, that's likely unsustainable.
- How do deposit patterns, such as dollar amounts and frequency, affect your risk?
- Does your overdraft program identify specific factors and behaviors to lower your institution's charge-off exposure?
- And most importantly, can you easily spot and mitigate risk with your current system? The best overdraft software evaluates every account, every day, adjusting limits as risk fluctuates.

2. Can you defend your overdraft program with real-world data?

When an examiner asks, can you back up your overdraft program with solid evidence? The method your program uses to determine overdraft limits and account performance should be defensible, transparent and objectively applied across your financial institution.

You should see clearly how every limit is calculated for every account over time: what's an account holder doing today compared to a month ago, or two months ago? Have there been fluctuations or changes in their deposit habits?

3. Can your system spot changes in an account’s risk profile?

The right overdraft program doesn’t just protect your institution from risk. It also safeguards your account holders’ financial well-being.

Think of an effective overdraft program like a hospital heart monitor: steady, consistent activity signals good health, but a sudden fluctuation raises the red risk flag. Your overdraft management system should keep a finger on the pulse of every account, every day, monitoring all changes in activity and adjusting limits to keep your risk in check.

In an April 2023 bulletin, the OCC highlighted this approach as a key risk management practice: “Periodic account analyses that result in appropriate changes to overdraft limits, eligibility for continued use, or recommendations to consumers for other appropriate deposit account services when overreliance, excessive costs, or options for more cost-effective credit usage are detected.”

Are you monitoring your accounts this way now and taking appropriate action? Can you automatically adjust overdraft limits when an account’s risk profile changes?

4. Are overdraft fee refunds handled fairly across your institution?

In our experience, many financial institutions maintain subjective policies for handling account holder requests to refund overdraft fees. These decisions are often left to branch managers or even frontline staff. Even institutions that claim to have formalized policies frequently leave decisions to employee discretion.

Here’s a simple example of the problem with this approach:

- **Branch A:** Located in an affluent suburb
- **Branch B:** Based in a struggling inner-city neighborhood

Without the right software, refunds hinge on human judgement. If Branch A consistently refunds more than Branch B, expect examiners to notice. A cursory review might lead them to falsely conclude that your institution is discriminating based on socio-economic status.

An effective overdraft program uses the same metrics and the same algorithm for every account, analyzing deposit behavior and overdraft history to evaluate refund requests. Machine-driven and objective, it ensures fair and equitable decisions, free of human bias.

5. Can your overdraft program analyze debit decline opportunities?

Debit declines reveal the cracks in your service, as well as missed chances to bolster your bottom line. The right software flags actionable events on every account: is this account holder a frequent overdrafter? Are they experiencing debit declines? Did they fail to respond to Reg. E, opting out by default?

This is where the opportunity lies. Declines hurt twice: your account holder receives poor service, and you lose potential overdraft revenue.

A consumer confused by a declined debit card might just need a quick chat explaining Reg. E to turn frustration into a win.

On the analysis side, your overdraft program should pinpoint where declines are happening and how big the problem is. Reporting should reveal the total amount of declined transactions and the corresponding interchange revenue slipping away with each one.

Better yet, the right overdraft software can automatically send a letter for opt-in, queue up a call or start a conversation. It can also help you dig into the root cause of debit declines:

“We declined $2 million in transactions yesterday due to default opt-outs, and 80% of those came from Branch 9. So, what’s going on at Branch 9?”

6. Does your pay ratio indicate your true service level?

Most financial institutions calculate their pay ratio with a simple formula: items paid divided by total items. So, if an account holder writes 10 checks and you pay 8, then you’re satisfied that you’ve provided an 80% pay ratio. But what if that same account holder had 10 debit card declines in that same period? That 80% starts to look less impressive.

In our experience, most financial institutions ignore debit declines in their pay ratio, which leaves you with a metric that doesn’t truly reflect the service you’re delivering. The debit declines drag down the effective pay ratio, whether you count them or not.

Checks get a safety net: even without overdraft software, there’s often a chance to review, decide, and approve with a fee if funds are short.

But a debit card decline is instant. There’s no opportunity for review or approval, just a rejected transaction. That can mean embarrassment for the account holder, especially in a store checkout line, and frustration no matter the cause. Your institution takes a double hit: lost revenue (overdraft fees and interchange income) and a disappointed customer.

The right overdraft program fixes this. It calculates a true pay ratio that includes debit declines, providing a more realistic picture of your service levels. With that, you can proactively manage your service while keeping debit transaction revenue flowing.

7. Do you know the risk level of each account’s mobile deposits?

Every consumer deposit carries some risk. FIs take a chance by letting account holders access funds before a check clears, but mobile deposits heighten the risk, due to the greater potential for fraud in this channel.

Does your overdraft program provide a mobile deposit risk ratio? It should. Using an account’s history and deposit patterns, your system should assign a risk score, much like it calculates overdraft limits. That score equips your institution to decide, with confidence, how much of the funds to release and when.

8. Can your program trigger custom communications with account holders?

When an account's behavior changes, hinting at higher risk, an effective overdraft program flags that behavior and automatically responds based on your criteria. For instance, if an account holder suddenly drops from four regular deposits a month to two, can your overdraft system identify that as a trigger and respond by setting up a phone call, email or letter?

A smart overdraft program automatically reviews every account, every day, for trigger events you've defined. The system then queues up the appropriate response based on your customized input, delivering efficient, timely service to your account holders.

Without this feature, your staff is stuck manually running reports and contacting account holders directly. Further, examiners might expect outreach for certain behavior shifts—can your software adapt and send custom communications on the fly?

9. Can you customize reports with all your system's data?

Can you identify every kind of data your software stores? Can you create and run any custom report without asking your technical team to write queries?

The single most critical feature of any overdraft program is this: a simple, intuitive interface that allows anyone at your institution build and customize reports using every bit of data in the system. You should also be able to save those reports and schedule them to run automatically or on-demand.

If your program forces you to lean on technical staff for basic reports, you're wasting time and money. You can't effectively manage an overdraft line of business without quick, easy access to the data that drives smart and timely business decisions.

10. Can your software find exactly where your charge-offs originate?

Every financial institution aims to cut charge-offs from its ledger. The obvious, knee-jerk fix is to reduce overdraft limits. The trouble is that when you reduce limits, you also shrink potential revenue and limit service for account holders. The real trick is minimizing charge-offs without hurting revenue and service, and the right overdraft program strikes that balance for you.

With the data in your system, you can pinpoint the riskiest accounts. The right overdraft software analyzes key variables to flag those most likely to end in a charge-off, letting you adjust limits with precision instead of an across-the-board cut.

Take Control of Your Overdraft Program

A solid overdraft program is transparent, user-friendly and manageable for every stakeholders. It gives you the insight to make smarter business decisions to boost efficiency, maximize service, and grow revenue.

Worried your overdraft program is a black box? Contact us for clarity.

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