The Latest Chapter in the Government's War on Purported "Junk" Fees: The CFPB Moves to Define Overdraft Services as Credit and to Cap Fee Amounts

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On January 17, the Consumer Financial Protection Bureau (CFPB or Bureau) issued its Notice of Proposed Rulemaking regarding proposed changes to overdraft fee rules for certain banks and credit unions. In the widely anticipated notice, the CFPB set out its plan to curtail overdraft and nonsufficient funds (NSF) fees, which, while recently declining, remain a $9 billion revenue stream annually for banks.

The proposed rule would bring certain above-breakeven overdraft programs within the scope of consumer credit under the Truth-in-Lending Act and Regulation Z.[1] Ultimately, the rule changes would force overdraft fees to be lowered from the typical $30 to $35 to a "breakeven" limit of between $3 and $14. Separately, the new rules would force banks to build out Reg. Z compliance measures for any overdraft programs that turn a profit.

While the changes would take effect for only "very large financial institutions" (i.e., with more than $10 billion in assets), the CFPB specifically notes that it will "monitor the market's response to this rule before determining whether to alter the regulatory framework for financial institutions with assets less than or equal to $10 billion." In short, the entire banking industry is on notice.

Background on the Proposed Changes

The CFPB's proposed rule changes come on the heels of its December 2023 report on the overdraft and NSF fee market, titled "Overdraft and Nonsufficient Fund Fees – Insights from the Making Ends Meet Survey and Consumer Credit Panel."[2] Therein, the CFPB conceded that overdraft and NSF fees had declined significantly in recent years (down from $25 billion to $9 billion) but noted that the Bureau's apparent work to eliminate such fees was not done. Noting that "over a quarter (26.5 percent) of consumers resided in a household charged an overdraft or NSF fee in the past year," the CFPB concluded that "[d]espite many financial institutions making changes to their overdraft and NSF policies in recent years, we find that consumers continue to be affected by these fees." The CFPB also focused on certain demographic and socioeconomic data pertaining to the incidence of overdraft fees and noted that the fees were charged disproportionately to an "economically disadvantaged" segment of consumers.[3]

The CFPB's proposed rule changes break down between covered and "non-covered" overdraft credit. As for non-covered overdraft credit, the CFPB claimed that it is returning the exception that has historically applied for overdraft credit under Reg. Z[4] to its original conception. The CFPB asserts that the Reg. Z exemption was

[1] 12 CFR Part 1026 et seq. (Reg. Z).

[2] *See* "Overdraft and Nonsufficient Fund Fees: Insights from the Making Ends Meet Survey and Consumer Credit Panel," CFPB, December 19, 2023.

[3] The CFPB stated in its report that "[c]onsistent with work documenting racial wealth and income disparities, we find racial and ethnic disparities in overdraft and NSF fee activity."

[4] 12 C.F.R. § 1026.4(c)(3).

only intended to exempt "overdraft services from Regulation Z when offered ***as a courtesy or accommodation to customers***" and not as a means to profit. Thus, under the new rule:

> "where a financial institution sets its overdraft fees at or below its ***breakeven point***, it provides a courtesy service to consumers who overdraw their accounts. Conversely, where a financial institution sets its overdraft fees ***above its breakeven point, and profits from those fees***, it cannot be said to be providing a courtesy."

In short, the CFPB proposed to modify 12 CFR § 1026.4(c)(3) to cover "above breakeven overdraft credit."

The CFPB also proposed to define "above breakeven overdraft credit" as "a charge or combination of charges exceeding the average of [the bank's or credit union's] costs and charge-off losses for providing non-covered overdraft credit as described in § 1026.62(d)." The CFPB also proposed to use the financial institution's "average" cost as opposed to any actual cost or estimated charge-off loss since banks generally track costs at the "product level," not "the transaction level." The CFPB proposed two methods for determining coverage — either apply a standard to compare the bank's fee to its costs, or simply use the CFPB's low "benchmark fee." The CFPB is currently considering setting the benchmark fee between $3 and $14. Setting the fee at the benchmark would allow the bank to remain exempt from Reg. Z pursuant to 12 CFR. § 1026.4(c)(3). However, anything above breakeven would bring the fees within Reg. Z coverage.

The proposed rule changes also incorporate changes to bank offset practices. For covered overdraft credit, the new rule proposed prohibiting the structuring of an overdraft as a negative balance in the consumer's bank account. Instead, banks would be required to maintain a "credit account" separate from the consumer's demand deposit account. Further, a consumer with an overdraft balance who receives an incoming deposit must be given access to the deposit and immediate offset to cover the overdraft would be prohibited.

Also, for overdraft credit accessible by card, the credit would be subject to the CARD Act provisions of Reg. Z.

Finally, the new rule would prohibit the compulsory use of preauthorized electronic fund transfers (EFTs) for repayment of covered overdraft credit.

Which Banks Would be Covered by the Rule Changes?

The rule changes currently only extend to "very large financial institutions," which are those with more than $10 billion in assets. As noted above, the CFPB makes clear that it is watching the entire banking industry's reaction to the proposed rule and specifically reserved the possibility of expanding the scope of the proposal. Revenues from overdraft fees make up a higher portion of the overall revenues for community banks compared to mega-banks, so community banks will be watching the rulemaking closely.

What's Next?

The comment period will close on April 1. Thereafter, the CFPB will consider public comments it receives and either release a revised proposal, an interim rule or a final rule. Even before the proposed rule was issued, the banking industry had begun a campaign against the rule changes. For example, the Consumer Bankers Association created a website dedicated to the issue at overdraftfacts.com. And, the American Bankers Association called the proposal "misguided" and an "effort to score political points" in an election year. Opposition is expected to mount as industry participants further digest the proposed changes.

What to Do Now

Financial institutions of all sizes should understand and assess any impact of the proposed rule changes. Even financial institutions that are not directly subject to the proposed rule (for example, those that do not meet the $10B

in asset requirement to be within the scope of the proposed rule), should still consider submitting comments to the proposal (due by April 1), or having a trade association or comparable group submit comments to the proposed rule changes.

Also, in light of the proposed limits on overdraft fees, banks should reevaluate whether to continue charging overdraft fees or possibly limit the types of transactions that will be paid into overdraft. Returned item and NSF fees are also indirectly impacted, particularly if they are connected to any overdraft credit. Therefore, banks should also reconsider in what circumstances NSF fees are charged.

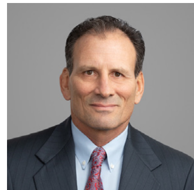
Whether a bank intends to continue charging overdraft fees (at the levels proposed by the CFPB, based on a "breakeven" analysis or at current levels subject to Reg. Z requirements), financial institutions must review and consider revising account terms and conditions, Reg. E Opt-In Forms and Fee Schedules.

Finally, it is anticipated that certain states may also take on overdraft fees on the tail of the proposed rule. Therefore, banks should understand any state regulatory risk that may exist with respect to their fee practices.

CONTACTS

For more information, contact your Katten attorney or any of the following Consumer Finance Litigation and Regulatory Compliance attorneys.

Eric R. Hail
+1.214.765.3638
eric.hail@katten.com

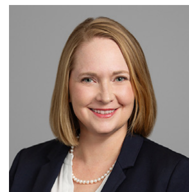


Stuart M. Richter
+1.310.788.4582
stuart.richter@katten.com

Christina J. Grigorian
+1.202.625.3541
christina.grigorian@katten.com

Ted A. Huffman
+1.469.627.7044
ted.huffman@katten.com

Eric T. Werlinger
+1.202.625.3553
eric.werlinger@katten.com



Katherine E. Chambers
+1.214.765.3625
katherine.chambers@katten.com

Katten katten.com

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