



Financial Services Management

Overdraft-Fee Restrictions

Cite

S. 2677, Stop Overdraft Profiteering Act of 2021

Recommended Distribution:

Consumer Finance, Retail Banking, Policy, Legal, Government Relations

Websites:

<https://www.congress.gov/117/bills/s2677/BILLS-117s2677is.pdf>

Impact Assessment

- Consumers would be better insulated from unexpected overdraft and NSF fees, perhaps increasing the appeal of regulated transaction accounts but also reliance on unregulated providers of short-term, small-dollar, high-cost loans.
- A major source of retail-banking fee income would be sharply reduced. Transaction-account availability, terms, and conditions could be altered in ways adverse to consumers to compensate for lost fee income although targeted accounts aimed at financial inclusion might mitigate this risk for some low-income consumers.
- Remaining overdraft/NSF fees would likely be set by the CFPB, sharply restricting them and creating precedent for federal pricing standards.
- Fintechs with bank-like transaction products would be exempt, perhaps increasing their market power.

Overview

Senior Senate Democrats have proposed legislation that would sharply restrict most transaction-account overdraft fees to the point of likely eliminating them for most consumers at most depository institutions. Non-sufficient-fund (NSF) charges would be similarly constrained and, where fees are allowed, transaction-posting procedures would make it impossible for consumers to pay multiple fees over several days even in the event of a small overdraft. This could provide significantly-increased consumer protection from nuisance and even predatory charges, but also make it harder for some consumers to handle urgent expenses without resorting to high-cost providers of short-term loans so far largely outside the reach of federal regulation. The measure is unlikely to pass but places more pressure on the CFPB to issue long-planned rules in this sector. Federal banking

agencies may also be more likely to intervene if they deem a bank's reliance on overdraft fees so large as to be an unsafe-or-unsound practice or if they view some fees as improper under current law or rule.

Impact

When GSIB CEOs testified recently before Congress,¹ they were roundly criticized by Democrats for both charging overdraft fees and the way fees are posted. This is not new – legislation has been pending in the House since at least 2007 to restrict posting practices.² Legislation in New York State to bar problematic posting has also recently been enacted, but federal legislation has largely been on hold since the CFPB promised to address overdrafts shortly after it was created by the Dodd-Frank Act in 2010.³

However, despite prior lack of action, criticism at the GSIB hearing was so strong that a trend already under way among large banks to cease charging overdraft fees kicked up steam. Even so, overdraft-fee income is a major source of earnings, especially for small and mid-size banks and credit unions. Indeed, a few derive so much of their income from these fees that their business model might be challenged in their absence. At a recent hearing,⁴ Sen. Van Hollen (D-MD) questioned Acting Comptroller Hsu about this; Mr. Hsu responded that the OCC might well view heavy reliance on overdraft fees to be an unsafe-and-unsound practice. He also indicated that an inter-agency effort is under way to assess large fees for small overdrafts.

The CFPB is likely also to ramp up attention to these fees once it gets a confirmed director or after it finishes its planned rulemaking against payday lenders, whichever comes sooner. Although the Bureau in 2013 finalized tough rules against payday lenders,⁵ the Trump Administration rolled most of them back. If consumers have difficulty getting sound short-term, small-dollar loans when they come close to zero in their transaction accounts, they may well turn to payday lenders or even less regulated short-term financial providers. Banks have sought to offer small-dollar, short-term loans with greater consumer protection. The banking agencies in 2020 authorized some lending in this sector,⁶ but few banks have entered this arena due to remaining regulatory costs and concerns. Instead, many have turned to offering targeted accounts designed for consumers who cannot access traditional transaction accounts, providing these low-cost accounts without overdraft fees to qualified customers.⁷ Low-income consumers might not need these targeted accounts if overdraft fees are essentially banned, but demand for them is more likely to increase because loss of fee income from consumers otherwise willing and able to handle overdraft fees would be eliminated across the balance of a bank's transaction accounts. As was seen when debit-card

¹ See *Client Reports GSIB18*, May 26, 2021, and *GSIB19*, May 28, 2021.

² See **OVERDRAFT4**, *Financial Services Management*, February 26, 2007.

³ See **CONSUMER14**, *Financial Services Management*, July 19, 2010.

⁴ See *Client Report REFORM207*, August 3, 2021.

⁵ See **PAYDAY6**, *Financial Services Management*, November 26, 2013.

⁶ See **PAYDAY9**, *Financial Services Management*, May 27, 2020.

⁷ See **Pick Your Poison: Abandoning Regulated Banking in Search of Financial Inclusion**, *Economic Equality Blog*, December 7, 2020.

interchange fees were reduced by law and rule,⁸ banks that lost this source of fee income sharply reduced their free-checking offerings and curtailed rewards and other features of debit-card offerings.

Payday lenders might not be the only industry beneficiaries of overdraft-fee restrictions as sweeping as those proposed in this bill. The measure covers only "depository institutions," defining these as now done in the Federal Reserve Act (i.e., banks, thrifts, credit unions). Many fintechs have recently offered products that compete with these depository institutions (dubbed banks in the balance of this analysis), but would be exempt from these restrictions unless the offering is so dependent on an insured depository as to come clearly under its restrictions. So large an exemption combined with the profit potential of and demand for overdrafts might well accelerate a wide array of nonbank deposit-like products with overdraft features. These could not only raise renewed consumer-protection concerns, but also safety-and-soundness risk to consumers and the payment system.

What's Next

S. 2677 was introduced on August 9 by Sens. Cory Booker (D-NJ) and Elizabeth Warren (D-MA). Senate Banking Chairman Brown (D-OH) likely supports it but has announced no plans for action. Similarly, HFSC Chairwoman Waters (D-CA) doubtless supports the most recent version of the House bill referenced above, which does not go as far as the Booker-Warren measure. Again, no action on it is planned.

Analysis

A. Disclosures

Banks offering overdraft coverage would have to clearly and conspicuously disclose in all marketing materials the fees related to overdraft coverage. Disclosures would also have to stipulate that no more than one overdraft fee per month and no more than six charges a year are allowed per each transaction account. Information about alternatives to overdrafts would also be required if these are offered and the CFPB could mandate additional disclosures.

In addition, periodic statements for transaction accounts allowing overdraft would need clearly to disclose all overdraft and NSF fees for the relevant period and year to date. No statements could show balances available via overdrafts as part of a transaction-account balance and any disclosures related to available funds would need to be less prominent than the actual balance.

B. Prohibitions

Overdraft fees would be barred for:

⁸ See **INTERCHANGE8**, *Financial Services Management*, May 18, 2021.

- ATM transactions; and
- one-time debit transactions.

Fees would also need to be forgiven for automatic, recurring payments. However, fees for such transactions and for checks would be permissible if the account has been opened for at least three days before the overdraft program is offered and the consumer has consented in writing or another form permitted by the CFPB. In addition, overdraft fees are not allowed when the fund insufficiency is due to a debit hold exceeding the actual transaction amount.

Posting would need to minimize likely overdraft fees. In addition, no more than one overdraft fee could be charged a month and no more than six fees each calendar year. Fees must be "reasonable and proportional" to the institution's cost directly associated with each such transaction although the CFPB (in consultation with the Fed, FDIC, NCUA, and OCC) could establish a safe harbor for fees likely to meet this requirement. NSF fees related to ATM and debit-card transactions would also have to be reasonable and proportionate on a per-transaction basis; the CFPB in consultation with the other agencies could again create a safe harbor.

Finally, institutions could not discriminate against consumers who decline overdraft coverage in terms of fees, coverage, and other terms compared to accounts with overdraft coverage. Depository institutions would be barred also from evading any of these provisions.

C. Notice

Consumers would need prompt, same-day notification via a method they select if overdrafts are triggered including information detailed in the bill. Similarly-prompt access is required if the institution terminates an account due to overdrafts.

D. Consumer Reports

Depository institutions also could not report overdraft information negatively to the consumer reporting agencies if the overdraft occurs in a coverage program. The bank would also need to ask the CRA to delete all previously-reported negative information related to overdrafts if the consumer repaid the overdraft.

E. Rule of Construction

Nothing in the bill could be interpreted as barring banks from paying overdrafts when no fee is charged.

F. Effective Date/Moratorium

Although the bill would take effect one year after enactment, the CFPB would need to issue implementing rules and any model forms no later than two years after enactment; the bill is effective even if no such rules are in place. During the one-year period between the effective date and any final rules, a moratorium would bar overdraft and NSF-fee increases from prior levels.