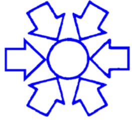

Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: June 27, 2022

My interview late last week with NPR's Marketplace on the CFPB's assault on credit-card fees sparked considerable comment mostly about how much people hate their credit-card fees. What's at stake here, though, is not one fee – it's the impact of a paradigm shift in the construct of U.S. consumer-finance regulation. If Rohit Chopra has his way – and he may well – consumer financial-protection standards will be transformed from reliance almost exclusively on disclosures into a federal construct of price-setting and product prohibitions. Political ideology may dictate a preference between these paradigms, but a choice that enhances effective consumer protection isn't that simple – disclosures have largely failed consumers, but nationalized consumer finance could crush consumer banks.

Historically, U.S. consumer-financial protection law depends on disclosure. Indeed, transformational law were called the "truth-in" acts because Congress believed that making financial providers tell the truth would set consumers free from predatory practice. Congress also understood that some practices were ill-governed by pages of ex ante paperwork or seemingly-comparable terms and thus set standards – when payments must be in hand – or provided express protections – $50 maximum charges for transactions that go astray. However, with few exceptions mostly instituted in 2010 after the crash, Congress did not allow regulators to set prices or prohibit even egregiously predatory products. Look for example at the Home Ownership Equity Protection Act, which principally required disclosures and did nothing to staunch high-risk mortgage finance and the crisis it fostered.

It's thus understandable that Rohit Chopra is done with all that. His attack on "junk fees" in general and credit-card late fees in particular is designed to set price ceilings past which no provider can go no matter how ineluctable its profit incentives. As with any form of price controls, this approach protects consumers. It does, though, also distort markets unless government price calculations are far better designed that pretty much any to date have ever proven.

Thus, disclosure-based consumer protection is often ineffective and government-set prices seem mostly counter-productive. How best to balance the competing objectives of protection and profit? Overdraft fees are a most instructive case study of a possible way forward for both regulators and providers.

Overdraft fees have been a thorn of contention for decades and the solution meant to pull it out were Fed disclosure standards along with a chance for consumers to opt out. Clearly, this didn't settle matters since these fees remained highly objectionable to consumer advocates, leading to still more calls for legislation and, in its absence, tough regulation.

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After overdraft regulation was handed over to the CFPB by the Federal Reserve, it talked about dealing with them during the Obama Administration and then fell silent under Mr. Trump. Although better disclosures perhaps might have alleviated consumer concerns, a decade of rancor over overdrafts makes so moderate a solution politically untenable even if it might have been substantively viable.

When Rohit Chopra took over the CFPB, it became clear that overdraft reform was among his top targets. He didn't just talk tough, he made it clear that he would go far beyond more disclosure standards expressly to outlaw certain fees and product terms. Indeed, he contemplated simply banning overdrafts no matter doubts over whether doing so was within his authority.

This was a credible threat not only of tough regulation, supervision, and enforcement, but also of an end to most transaction-account fees. Feeling the heat at its back, the industry took action on its own, with many banks sharply revising or even eliminating overdraft fees for most transactions. Costly though this was – the American Banker last week estimated a price tag of $4 billion – many banks decided that the cost was worth bearing given the prospect for a CFPB rule that would go considerably farther than the banks thought necessary or, indeed, than many consumer advocates demanded.

This compromise persuaded Congress last week not to act. Mr. Chopra might try to do so, but he has praised industry self-regulation and, should he still pursue overdrafts, it's likely to be at the outlier institutions still charging them. The compromise now before us is one in which consumers have gained far more than disclosure and ill-understood opt-outs afforded but best-practice banks saved much of their deposit business model. The combination of credible threat and self-regulatory action has thus led to a satisfactory solution.

History shows that rules premised principally on disclosure usually do not contain practices strongly objectionable to consumer advocates but rules strongly objectionable to banks are not always needed to curb abuse. As Rep. Maloney pointed out, we do not have a permanent solution to overdrafts because another CFPB director could overturn it. However, it's nonetheless a lasting solution covering most banks and consumers that's far better balanced than disclosures alone or express "junk-fee" ceilings would provide.