Credit-Card Late Fee Regulation

Cite

CFPB, Notice of Proposed Rulemaking, Credit Card Penalty Fees (Regulation Z)

Recommended Distribution

Consumer Finance, Card Products, Policy, Government Relations, Legal

Website

https://files.consumerfinance.gov/f/documents/cfpb_credit-card-penalty-fees-nprm_2023-01.pdf

Impact Assessment

- Eliminating the manner in which current fees are set and the inflation safe harbor would put the Bureau into the price-setting business, one it could expand to other consumer-finance sectors where it finds what it believes to be "junk fees."
- Consumers could save as much as $9 billion on late fees, but these savings could be offset by higher interest rates for some or all credit-card borrowers, diminished credit-line capacity, increased up-front fees, and/or reduced rewards.
- Consumers unable to qualify or afford cards on revised terms may turn to payday lenders, loans with a considerably higher cost than the fees associated with late-payment fees and grace periods.
- The cost to issuers could be more than the $9 billion consumers might gain if the absence of meaningful fees encourages borrowers to run persistent overdue balances. The Bureau believes $8 at each past-due date suffices to defer strategic delinquency without the current, higher fees that now also rise as delinquencies persist.
- CFPB analytics supporting this rulemaking raise numerous methodological, analytical, and procedural challenges that may slow or even prevent implementation regardless of a Bureau's decision to issue a final rule along proposed lines.

Overview

Following on a controversial advance notice of proposed rulemaking,[1] the CFPB has now released an NPR setting specific standards for credit-card late fees that also eliminates the inflation adjustments established by the Federal Reserve when implementing the 2009 credit-card law.[2] The NPR also seeks comment on still more stringent late-fee restraints and limits on some or all of the

[1] See **CREDITCARD35**, *Financial Services Management*, July 5, 2022.

[2] See *Client Report* **CREDITCARD34**, May 7, 2009.

other penalty fees now charged by some credit-card issuers. When issuing the ANPR, the Bureau also noted that it plans to advance other initiatives under its "junk-fee" standards,[3] likely starting with those pursuant to the Electronic Funds Transfer Act affecting a wide range of payment and transaction-account products. Should it then follow the model proposed here for credit cards, significant alterations in current business practice could occur with uncertain consumer benefits despite nominal upfront savings.

Impact

The NPR would override provisions in the current Fed rule affording immunity from enforcement actions if initial late fees are set at $30 subsequently adjusted to reflect inflation without the need for a lender to conduct a calculation to ensure that its own fees are "reasonable and proportional" as required by law. Issuers need not use the safe harbor and may instead set their own penalty fees based on cost analytics detailed in the Fed's rules, but the Bureau finds that no issuer has chosen to do so because an accurate, current cost analysis would lead to far lower penalty fees than allowed under the Fed's save harbor.

Indeed, in his comments accompanying release, Director Chopra made it clear that he believes the base rate set by the Fed over a decade ago is unduly high due to actual costs and that lenders may now also use high rates of inflation to push late-payment fees to levels that are in fact neither reasonable nor proportional given the actual risks and costs. The Bureau for example finds that the cost of late fees is generally only about one-fifth of the current safe-harbor amount, noting also that issuers for which costs are higher are free to calculate their own costs rather than rely on the safe harbor.

The NPR was released in concert with a meeting of the White House Competition Council, leading both the President and Mr. Chopra to link what they believe are unduly high late fees also to concentrated market power. This is inferred because the Bureau finds that consumers do not shop for cards based on late fees, instead looking at factors such as rewards. That consumers may do so because these alternative product features are of more importance to some consumers, especially those who expect to pay bills on time, is not addressed in the NPR.

Reducing late-payment fees could encourage consumers to change their behavior and defer repayment on a regular basis. However, the Bureau states that there is little reason to expect this because a repeated $8 fee is sufficiently costly to consumers who also face other costs (e.g., higher rates, lower scores) that deter strategic delinquency. The CFPB also believes that issuers have additional tools (e.g., automatic-payment plans, early warnings) that effectively deter consumers from abusing card payment requirements. The Bureau also notes that terms and conditions can reduce issuer credit risk, pointing for example to issuer ability to curtail credit lines for consumers likely to pay late. It is unclear if consumers would benefit from reduced or even withdrawn lines and thus the lack of a buffer prior to default versus higher penalty fees. Comment is, though, solicited on this point.

[3] See **CONSUMER38**, *Financial Services Management*, February 1, 2022.

The Bureau also seeks comment on still more changes to card fees. Among these would be a ban on penalty fees if a late payment is received within fifteen days of the due date. This would likely change the card payment cycle to 45 days, reducing by half the total payments issuers would receive from borrowers who time payments to the end of the billing cycle. Borrowers without outstanding balances on which interest is charged above the minimums paid at or before the 45-day deadline would incur still more interest expense than would have been the case with prompt payment of at least some of the balance due, with issuers also forced to reset their expectations about payment inflows and thus perhaps also increase overall rates to compensate for larger amounts of outstanding credit balances. Securitization patterns for revolving cards now premised on a thirty-day payment cycle would require considerable restructuring that could be very challenging to execute on outstanding asset-backed securities.

The proposal also includes what are sure to be controversial conclusions that the $8 safe harbor fee adequately compensates issuers for late-payment costs along with providing compliance simplicity and administrative certainty. The Bureau acknowledges that basing its safe-haven amount on average card costs derived from large issuers ignores the differences in targeted business models, but it concludes that this is appropriate because it has decided on an approach applicable to all issuers. Small issuers and those issuers in fact focused on subprime borrowers or other more complex market segments could nonetheless abandon their offerings if this average cost in fact is far lower than those the incur. This could leave market segments ill-served by cards, forcing those who now make payments on time to find alternative payments instruments that may be riskier and/or find it more difficult to manage monthly cash flow. Borrowers who make late payments and thus incur longer-term debt might make use of payday lenders or other, more costly forms of credit that the Bureau has elsewhere considered to be predatory.

If the Bureau resets late fees as proposed and issuers in fact find costs or risks subsequently increase, then credit-card interest rates and rewards could be realigned in ways that adversely affect cardholders who generally or even always make payment in full on required minimum amounts or their entire balances. The social-policy benefits of shifting costs in this fashion on a consumer-finance product raises complex equality, inclusion, and access questions not addressed in the analysis leading to this NPR and were also neglected in the questions posed by the ANPR.

What's Next

This NPR was released on February 1; comments are due by the later of April 3 or thirty days after *Federal Register* publication. In his February 7 State of the Union Address, President Biden singled it out for praise, suggesting that the CFPB will move quickly to implement a stringent standard. This may then face procedural challenges. For example, the Bureau has proceeded to a rulemaking without convening the small-business advisory committee the law

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requires when its rules may affect small companies. As noted above, it decided to prose the $8 safe-harbor amount based on large-issuer data; should small issuers believe as several have already asserted that these data do not represent their costs, they are likely to raise procedural as well as policy challenges to the rulemaking. Perhaps anticipating this, the NPR indicates that the Bureau sought data from issuers on late-payment costs in the ANPR but received none. It also notes that its own data show that small issuers charge smaller fees than the largest ones captured in the data on which the NPR principally relies.

Analysis

A. Penalty Fees

As noted, the safe harbor for all late-payment penalty fees (including those for lengthy delinquency and repeat violations) would be reduced from $30 to $8; the $30 safe harbor would continue to apply to other penalty fees pending comment on options discussed below. Add-on penalty fees for late payments would also no longer be covered by a $40 safe harbor and provisions that allow fees to be as much as 100 percent of the minimum balance would be revised to provide for a 25 percent limit. However, charge-card issuers could impose a penalty of as much as three percent of an outstanding balance for prolonged delinquency.

Inflation adjustments would also not apply to the late-fee safe harbor, although they could continue to do so for other card-related penalty fees. The Bureau has decided on the inflation adjustment that is usually a noncontroversial feature of dollar-based regulation on grounds that the deterrent rate of proposed $8 fee is high enough, deterrence impact does not move in “lock-step” with inflation, and adjustments can and will be made if and when warranted. Thus, the CFPB has preliminarily decided that its overall approach ensures that late fees are “reasonable and proportional” as required by law with greater regard to market developments than in the Fed’s decade-old standard.

B. Disclosures

The NPR also includes sample forms, bills, and similar materials to ensure compliance and consumer understanding of the new late-fee approach on which comment is solicited.

C. Request for Comment

Views are also sought on:

- whether late fees should simply be prohibited if the required balance is paid within fifteen days after the deadline;
- whether use of the $8 safe harbor should be contingent on the availability of automatic-pay options, notice of the due date within a certain number of days, or both;

- whether limits similar to those above should be applied to other penalty fees (e.g., over-limit, return payment, denied access) or if safe harbors should be eliminated for all fees;
- the need to change cost analyses in the absence of the safe harbor in ways that go beyond the proposed change eliminating consideration of collection costs;
- whether there should be more or different clarifications to the commentary;
- the merits of the NPR's cost analysis and the proposed deletion of collection costs from those applicable to alternative cost calculations;
- an array of alternative approaches to permissible late fees;
- whether to retain an inflation adjustment factor; and
- the benefits of a fifteen-day or similar grace period before any late fee may be assessed.

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