Financial Services Management

Overdraft Fees

Cite

CFPB, Notice of Proposed Rulemaking, Overdraft Lending: Very Large Financial Institutions

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Website

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Impact Assessment

- Many of the banks actually reliant on overdraft fee income would be exempt from these standards, often leaving consumer risk unaddressed and exacerbating it as larger banks reduce overdraft options.
- Overdraft fees could actually go up as fewer lenders choose to offer them.
- Banks could charge higher fees if these come with numerous disclosures. Consumers would have additional information as to the cost of large-bank overdrafts, but may not heed these given the emergency nature of this product. Should bank overdraft loans be cheaper but less available, consumers are likely to turn to costly nonbank and small-bank products.

Overview

Building on a bulletin and circular from late 2022 warning banks about certain overdraft practices,[1] the CFPB has now proposed a rule that would sharply and expressly limit fees for extensions of credit related to overdrawn transaction accounts unless the account comes under an array of consumer-protection requirements. Part of the Administration's campaign against "junk fees," the proposal sets a "break-even threshold based on a bank's costs" and provides for an alternative break-even benchmark CFPB-set fee that would allow a lender to avoid costly additional regulatory requirements, expanding the Bureau's recent focus on mandating industry pricing evident in its controversial proposal on credit-card late fees.[2] Lines of credit and ready access to credit-card credit associated with overdrafts would also come under new limits and come under additional consumer-protection standards.

1 See **OVERDRAFT11**, *Financial Services Management*, October 31, 2022.

2 See **CREDITCARD36**, *Financial Services Management*, February 8, 2023.

Impact

The proposal overrides exceptions made by the Federal Reserve starting in 1969 to the Truth-in-Lending Act (TILA) related to extensions of credit on overdrawn transaction accounts. The Bureau here notes that the Board's action dates to a time when overdrafts were infrequent and inadvertent. Since then, fees related to them have become what the Bureau's director calls a "big-bank junk-fee harvesting machine." Although many of the very largest banks have significantly curtailed or even dropped overdraft fees in recent years, the preamble states that fees of at least $35 are still widespread, with many banks structuring internal models to maximize fee revenue with no transparency to depositors.

As detailed below, the main change proposed by the CFPB builds on the agency's decision directly to set consumer-finance fees first established by the credit-card late-fee proposal. However, these late fees come under an express provision of law requiring regulator-set pricing. Here, there is no such statutory mandate, with the agency on its own setting pricing by differentiating overdraft credit provided at break-even – i.e., no profit – rates to consumers and for-profit overdrafts that, by virtue of this pricing are deemed not to be the "courtesy" product stipulated by the FRB in its TILA regulation that thus require the full range of TILA-mandated disclosures and advertising restrictions. This may enhance consumer protection by shielding overdraft borrowers from costly, unanticipated fees, but consumers may not take these precautions into account and just seek funding to cover their obligations when under financial stress. Banks may find it burdensome to comply with all the TILA restrictions unless they raise overdraft fees. Should banks be unwilling to offer overdrafts at break-even rates or decide that TILA compliance is too costly, then the result of the proposal could be both fewer overdraft lenders and greater cost to consumers in need.

It is also unclear if this break-even concept is proposed under sufficient statutory authority. As discussed below, the CFPB is not mandating only break-even pricing; rather, it makes this a condition for exemption from TILA requirements. However, opponents may still counter by arguing that rules such as these that bar profits on legal products are confiscatory, a violation of Constitutional prohibitions against the federal government doing so except under limited circumstances. Perhaps anticipating this challenge, the Bureau states that its rule would be severable – that is, other provisions in the rule would stand even if others are struck down by the courts.

The proposal's title indicates that the Bureau believes it covers "very large" banks, but it in fact reaches down to banks with $10 billion in assets, a threshold that if breached requires additional rulemaking protocols that would slow CFPB final action. Some of these "very large" banks may be among the banks now most likely to use overdraft fees as a significant earnings source, but most are considerably smaller and would be untouched by proposed fee constraints even though exempt banks receive twice the amount of overdraft fees per deposit dollar than the banks that would come under this rule based on data in the NPR. The Bureau does indicate, however, that it will monitor the market to determine if broader coverage is warranted.

In addition to the CFPB's direct and indirect actions against overdrafts, the FDIC and OCC – but not the FRB – last April issued supervisory guidance stating that authorized-positive/settlement-negative transactions that result in overdraft fees are an unfair and deceptive act or practice (UDAP). The OCC's guidance also adds numerous other overdraft-related practices as UDAP, thus making it unclear how many remaining practices at very large banks raise the acute consumer-protection concerns cited by the Bureau to justify this action.

The Bureau counters other concerns by emphasizing that TILA disclosures for overdrafts would be comparable to those for other credit products (e.g., credit-cards) and thus ensure that consumers choose the most cost-effective way to cover their shortfalls. However, the agency also notes that overdrafts are most frequent and costly to low-balance transaction accountholders. Some of these may have limited access to overdraft alternatives within the new TILA construct or have options via high-cost products such as subprime credit-cards. Given that payday lenders and other nonbanks are not burdened by the proposed rules, their products may seem more attractive even though they are often considerably more costly than even the overdraft fees the agency decries.

As discussed below, the proposal would consider debit-card overdrafts that are converted into credit-card balances on hybrid-cards as open-end credit under the protections of the Credit CARD Act.[3] This adds numerous consumer protections, but the Bureau believes it also opens up new overdraft products (e.g., long-term emergency facilities, grace periods, special subprime products with higher rates than applicable to exempted overdrafts) that could advantage consumers in contrast to current overdrafts. However, the proposal makes several changes in applicable credit-card rules to provide the protections the Bureau believes necessary for vulnerable consumers. For example, the proposal would bar penalty fees if the credit card issuer declines to honor the overdraft incurred on the affiliated debit card regardless of whether the penalty charge appears on the debit or credit-card unless the debit-card fee complies with the standards for overdraft fees. Hybrid-cardholders could also dispute overdrafts with the same rights applicable to a credit-card charge.

What's Next

The CFPB released this proposal on January 17; comments are due by April 1. This is an unusual deadline linked neither to the proposal's release date nor when it appears in the *Federal Register.* It may be designed to give the Bureau time to finalize the rule well before the election in order to protect it from repeal in a Congressional Review Act action akin to that which earlier this year would have reversed the agency's small-business reporting rule but for a Presidential veto.

The final rule would take effect on the October 1 that is at least six months from the date of publication of the final rule.

[3] See **CREDITCARD34**, *Financial Services Management*, April 30, 2009.

Analysis

The proposal states that the CFPB has consulted with all applicable federal agencies as required by law. In addition to the formal proposal, the Bureau also released a redlined version of the manner in which it would amend related commentary. The new final rule would remain the controlling document.

A. Scope

As noted, this proposal would cover IDIs and credit unions with over $10 billion in assets.

B. TILA Requirements

1. Protected Overdraft Fees

The rule would address overdraft fees as follows:

- TILA would not apply if fees are “break-even” judged by the average cost and losses on the bank’s overdraft loans under a methodology prescribed in the NPR that expressly bars considering deposit-product overhead as a cost. If a bank chooses not to calculate its own benchmark, then the Bureau is considering a simple “bright line” benchmark that could be $3, $6, $7, or $14.
- Alternatively, the bank could charge its desired fee but overdrafts would become subject to TILA. Under this option, the overdraft fee would be treated the same as an ordinary finance charge.

2. Hybrid Debit/Credit Cards

Hybrid credit/debit-card overdraft fees also come under these restrictions, with all use of card loans bringing the overdraft under the full range of credit-card disclosure standards along with the underwriting requirements covering card loans unless the card loan fees or interest rate are break-even to be considered a courtesy product exempt from TILA

C. Additional Provisions

Lines of credit provided to cover overdrafts would not be exempted from TILA regardless of pricing. Account-opening TILA standards do not cover such lines in existence prior to the rule’s effective date, but other requirements – e.g.-in-term notices – would cover these lines.

Compulsory use of pre-authorized electronic funds transfers to cover overdrafts would be prohibited, but consumers could opt into these lines and retain the right manually to repay the overdraft by another method. The proposal does not make clear if this right would need to be available for all overdrafts or only offered from time to time if a customer elects an automatic-payment feature.

Overdrafts could not be represented as negative balances and must instead be housed in a separate credit account. This effectively bars banks from using incoming deposits to offset an overdraft, giving consumers free use of deposits as they decide when to repay the overdraft housed in the credit account. The approach may prove insufficient to reflect actual costs and losses if the offset leads consumers to extend their overdraft indebtedness beyond current timeframes.

D. Request For Comment

The Bureau expressly seeks comment on matters such as:

- the benchmark bright-line fee options;
- the benefits of the break-even exemption and the manner in which banks could calculate costs and losses;
- whether additional, specific disclosures beyond those mandated by TILA are appropriate for overdraft fees not calculated under the break-even or benchmark options;
- provisions applicable to lines of credit; and
- the new hybrid-card approach.

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