Credit-Card Late Fee Regulation

Cite

CFPB, Final Rule, Credit Card Penalty Fees (Regulation Z)

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Websites:

https://files.consumerfinance.gov/f/documents/cfpb_credit-card-penalty-fees_final-rule_2024-01.pdf

Impact Assessment

- Eliminating the manner in which current fees are set and the inflation safe harbor puts the Bureau into the price-setting business, one it soon plans to expand to mortgage closing costs and other retail-banking fees.
- Consumers could save as much as $10 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.
- The cost to issuers could be more than the $10 billion consumers might gain if the absence of meaningful fees encourages borrowers to run persistent overdue balances. The Bureau believes $8 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.

Overview

Following a very controversial proposal,[1] the CFPB has finalized credit-card late-fee restrictions in a final rule that does not differ significantly from the proposal on its key point: elimination of the manner in which inflation adjustments are now made by credit-card lenders when it comes to late fees. The rule will sharply curtail issuer revenue related to these fees, likely affecting the market as a whole rather than the large issuers expressly covered by the new rule. Although the Bureau did not go as far as proposed in several areas, its core late-fee standard could lead lenders to raise interest rates, curtail rewards, reduce high-risk exposures, or otherwise redesign products with adverse implications for borrowers who meet their monthly-payment requirements in a timely fashion.

1 See *Client Report* **CREDITCARD36**, February 8, 2023

Impact

Shortly before this rule was issued, the CFPB released a study asserting that the largest credit-card companies charge the highest fees and interest rates, a finding Director Chopra used when he then opposed a pending credit-card bank merger. He also endorsed the President's strike force aimed at both competition and junk fees along with issuing this rule. It is similar to the proposal, premised as much on the Bureau's goals to increase competition as it is on findings that late fees are unduly high based on large-issuer costs, adversely affecting consumers often subject to repeat late-fee or penalty charges.

The final rule thus overturns the inflation adjustments established by the Federal Reserve when implementing the penalty fees covered by the 2009 credit-card law,[2] overriding provisions in the current Fed rule affording immunity from enforcement actions if initial late fees are set at $30 subsequently adjusted for inflation as prescribed in the standard. The CFPB has concluded that 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 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 smaller issuers for which costs are higher are free to calculate their own costs rather than rely on the safe harbor.

However, the manner in which costs may be calculated remains controversial. For example, lenders may not include the cost of collection efforts following account charge-off. The industry strongly argued that these are late-fee related costs, but the Bureau rejected this on grounds that default is not voluntary on the consumer's part and costs are thus independent of those associated with late fees.

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. The final rule in several places notes that lenders can adjust for higher risk or the cost of lost late fees by raising interest rates on card balances or curtailing rewards. Credit lines are said also to be adjustable to offset risk, but this could also adversely affect consumers with unanticipated payment challenges forced to resort to payday lending or other high-cost options such as repeat card nonpayment. It does not provide any analysis substantiating the overall consumer benefit of generally higher rates for consumers repaying minimum or even higher balances in a timely fashion versus those of lower late fees to borrowers unable to do so.

As noted below, only some provisions in this rule apply to large issuers as the CFPB decided to define them. However, small issuers fear that market changes would effectively force them to comply with changes such as the $8

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

safe-harbor fee because consumers would otherwise ignore their products. It seems likely that some, if not all, of the rule will thus apply to small issuers, posing burden and product viability the Bureau discounted based on its view that the rule did not expressly cover small issuers. This effect would perversely increase the market concentration the Bureau seeks to avert with fee restrictions.

What's Next

The CFPB issued this final rule on March 5; it is effective 60 days after publication in the *Federal Register.* However, the rule is already being challenged by efforts in Congress to repeal it via the Congressional Review Act. Such a resolution might pass the House, but it faces significant obstacles in the Senate along with a certain Presidential veto. Reflecting this political forecast, efforts to overturn the final rule in the courts are already underway.

Analysis

A. Scope

As discussed below, provisions in this rule cover only larger issuers, defined as those which together with their affiliates have a million or more open credit-card accounts. This covers about 95 percent of outstanding balances although the rule applies only to 33 of the 4,000 issuers.

B. Permissible Fees

1. Late Fees

The safe-harbor for governing large issuers' initial and subsequent late fees is reduced to $8 from $30. There is no prospective inflation adjustment.

If the lender chooses not to use the safe harbor, then it must undertake a fee calculation based on collection costs other than those related to collection after charge-off on rounds that costs related to non-payment are not the same as those designed to be covered by the late-payment fee and relate to loss mitigation, not payment delay. The Bureau also notes that interest rates and other methods best account for default risk. The cost calculation must otherwise be reasonable and proportional to actual permissible costs.

Other late-fee related penalties are limited to $32 for the first late payment and $43 for repeat violations within six months, with these limits covering all issuers and adjusted for inflation.

These provisions do not apply to charge cards, which may continue to charge fees on seriously-delinquent accounts of up to three percent of outstanding balances.

2. Penalty Fees

The final rule does not apply the $8 limit to over-the-limit, return-payment, and declined-access fees as suggested in the NPR.