# Consumer Finance Monitor (Season 7, Episode 15): A Close Look at the Consumer Financial Protection Bureau's Proposed Rules on Overdraft and Nonsufficient Funds Fees

Speakers: Alan Kaplinsky, John Culhane, Kristen Larson, and David Pommerehn

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. I'll be moderating today's program. For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com.

We've hosted our blog since July 21, 2011, when the Consumer Financial Services Bureau became operational. So, there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. To subscribe to our blog or to get on the list of our webinars, please visit us at ballardspahr.com. If you like our podcast, please let us know. Please leave us a review on Apple Podcasts, YouTube Music, Spotify, or wherever you get your podcasts. Also, please let us know if you have any ideas for all the topics that we ought to consider covering or speakers that we should consider inviting as guests on our show.

I'm also very pleased to tell our listeners that our podcast show was recently ranked by Good2BeSocial as the best podcast show among law firm podcast shows in the United States devoted exclusively to consumer financial services. Good2BeSocial is a prominent law firm consulting firm owned by best lawyers. We're very gratified by this recognition from one of the country's leading social media consultants for law firms. So, today's podcast show is a repurposing of a webinar which we conducted on March 5th entitled, "What do the CFPB's proposed rules on overdraft and NSFVs mean for you?" So turning to our program today, let me introduce a very good friend and somebody that I've known for many years, and that is David Pommerehn.

David is general counsel, had a regulatory affairs, and Senior VP of the Consumer Bankers Association. His expertise covers a wide range of legal, legislative, and regulatory issues associated with consumer finance. He is a CBA lead for deposits and payments issues, as well as small business banking issues, and he manages CBA's deposits and payments and small business banking committees. Prior to joining CBA, David served as the defense attorney for the State of Maryland and as counsel for several nonprofit financial services companies. I am going to just mention my two colleagues that are joining today, John Culhane and Kristen Larson. So, let me turn to our agenda and let me just give you a quick overview of what we're going to be covering today.

We're going to be looking at two proposed rules. First, we're going to look at the CFPB's overdraft credit proposal, and as you can see, we're going to run through several bullet points there. Each of our speakers will be covering different bullet points. Then once we've completed that, we are going to get to the non-sufficient funds fee proposal and we'll follow the same practice there. That is the same agenda in terms of covering various aspects of that proposal that we think will be of interest to you. So, with that, let me now turn the program over to Kristen.

Kristen Larson:

Welcome, everyone. First, we're going to talk about the overdraft credit proposal as Alan had mentioned. First of all, the CFPB issued a justification for here's why we're making the rule. They say they're trying to close a loophole. If you saw in today's credit card rulemaking, they also call that closing a loophole. This goes along with their junk fee agenda where they're

attacking a lot of bank fees as junk fees. They state that they're going to rein in excessive overdraft fees charge and that they're going to save consumers $3.5 billion or more per year. In addition to doing the proposal, they also published a fact sheet in a report on the overdraft and NSFB practices at very large financial institutions.

Some of the key provisions of the overdraft credit proposal, one thing to keep in mind is this has limited to apply to only very large institutions, which is defined as institutions with over 10 billion in assets. Essentially, what it does is it creates overdrafts into two different categories. There's a courtesy overdraft services and that's where you charge a breakeven amount for the services, which generally isn't like your $32 or $35 fee that may be charged now, because you have to look at the direct costs, provide the service or some benchmark fee. The breakeven overdraft credit service will be subject to Reg E, and then they'll treat that as non-covered overdraft services, which will avoid the Reg Z coverage. But to be in that category, again, you have to charge that small benchmark fee.

In the proposed rule, they suggest $3, $6, $7, or $14. It's not sure where they're going to land, but I think based on the final rule of the late fee, we expect it probably won't be the $14 or you can charge your prorate a share of your direct costs and charge off losses for providing that, but that's again, going to be something where you'd have to show your map and how you came up with the calculation. Then they also explain that for the prorate shared calculation, you can only consider certain costs and charge off losses that are traceable to the cost of providing the service in the previous year.

They give the examples of cost of funds, net charge-offs, operating expenses for the program, but you cannot use your general overhead costs or charge-off losses due to unauthorized use, electronic fund transfer errors or billing errors, return deposited items, or practices to rescind provisional credit. Again, what they're doing for the above breakeven credit is they're closing the loophole that was in Reg Z. So, what that's going to do is it's going to subject those credit accounts to compliance with Reg Z credit disclosures and Regulation E's compulsory use prohibition and obviously other laws that apply to extending credit like the COA Military Lending Act and SCRA.

For a covered overdraft credit, you cannot draw the checking account negative. It must be structured as a separate overdraft credit account from your asset account. Similar today, how you would set up an overdraft protection line of credit account. Again for regulation ease, I previously stated they're amending the compulsory use and saying the exception for overdraft credit does not apply to the overdraft credit. That's now changed in the Reg Z. They also changed the interpretation as well. The next thing that they did is they modified the definition of financial, your finance charge. Essentially, what they're doing here is they're saying that when you are charging fees above the breakeven overdraft credit, those fees are finance charges.

They give some examples of authorizing paying an overdraft, declining to authorizer pay a transaction, returning a transaction on paid, transferring funds into the checking account from any credit account or asset account. Then they're also applying the credit card application and solicitation provision to the hybrid debit credit cards. They have some key definitions. I am not going to read these for you here, but we included these essentially for your reference. As I mentioned earlier, the hybrid debit-credit card is a debit card that can be used to access an overdraft credit. These are some of the other key ones.

Again, we talked a little bit about what's covered and what's not covered. For a covered overdraft credit account, that's going to be any line of credit, credit card through which you extend or can extend overdraft credit. Again, there's the card for breakeven overdraft credits as well. Next, I'm going to turn it over to John to talk about the legal authority.

John Culhane:

Thanks, Kristen. So, I don't know that there are any real surprises here. What the CFPB has done in setting forth its legal authority for the rule is basically cite every statutory provision that authorizes rulemaking in this space, primarily the Truth in Lending Act and Regulation E, but also the Truth in Savings Act and Regulation DD.

I think the principle provisions that the CFPB has relied on are its own authority under Dodd-Frank, and then the very special provisions in the Truth in Lending Act and in the Electronic Fund Transfer Act that allow it to issue regulations that contain such additional requirements, classifications, differentiations, or other provisions, and provide for such adjustments and exceptions for all or any classes, class of transactions that they judge to be necessary or proper to effectuate the purposes of the Truth in Lending Act or the purposes of the Electronic Fund Transfer Act to prevent circumvention or evasion of the statutory and regulatory requirements or to facilitate compliance. These aren't rulemaking provisions that have been relied on very often.

I think probably the one rule that we're most familiar with under the Truth in Lending Act is the more than four payments rule, assuming that there's an embedded finance charge in any credit transaction that has more than four payments. So, Truth in Lending disclosures are appropriate, and that rule issued by the Federal Reserve Board went up to the Supreme Court and was approved in Mourning v. Family Publications. But there's really been very little activity since then. That was an interesting set of facts as well, and the case is an interesting case. One other provision of the Electronic Funds Transfer Act that the CFPB relies on is that in Section 904, there's also a provision that allows the CFPB to make modifications for small institutions.

We'll come back to that when we talk about observations and potential legal challenges because that provision is notably absent from the Truth in Lending Act. Then as I mentioned, the provisions in Dodd-Frank, that grant rulemaking authority to the CFPB, which broadly authorize the CFPB in case it actually needed this authority, which it probably doesn't, to issue rules to carry out the purposes and objectives of the federal consumer financial laws. Obviously, that includes the Truth in Lending Act, the Electronic Fund Transfer Act, and the Consumer Financial Protection Act and to prevent evasions thereof.

So, lots of focus on rulemaking intended to prevent evasions of statutory and regulatory provisions and lots of discussion as Kristen mentioned in the supplementary information section of the rulemaking proposal as to why this is necessary and what kind of evasions or circumventions are being curtailed here. Let me stop here and turn it over to David to talk about some of the business implications of the rule.

David Pommerehn:

Thanks, John. So, hello, everyone. So, yeah, I mean obviously this is going to affect how large institutions provide their consumers with liquidity options such as overdraft. I want to point out first though that the downward pressure on DDA or checking accounts and the pricing of those accounts is being hit from a lot of different sides at this point, right? So you have the overdraft proposal, which obviously would likely eliminate currency overdraft services as we know them today, not allowing for that fee income and the application to checking accounts for what are often low or no cost checking accounts. But it's not just overdraft, it's also the Reg II proposal that's out there that cuts the interchange rates by almost a third.

As we've seen in the past, when you cut those rates as we did back in 2010 by significant amounts, those costs are usually passed on to consumers. In that case, the merchants won out because it was a merchant to bank transaction, but you have to account for the cost of these accounts. So, that is currently underway too with the Federal Reserve and comments I believe on that are due in April or May, I believe. Then there are some other issues. If you treat overdraft as a credit feature or a finance charge under Regulation Z, the new Basel III endgame, well, the proposed Basel III endgame requirements... Comments have closed there. We haven't received a final rule there. ... would require that banks retain capital against that risk under Basel III endgame.

So, again, another hit to the profitability or even the cost proposition of a checking account. There's one other issue or two couple other issues that are tangentially touching this as well. There's a 1034(c)advisory opinion that came out of the Bureau that requires banks to provide information to consumers upon request without undue impediment or unreasonable impediments. Those impediments could be things such as charging for a paper statement or things of that nature. It's unclear how the Bureau is going to enforce against the advisory opinion, but it's certainly going to be looking at fees with checking accounts and the ability for consumers to get information about the checking accounts and whether or not you could provide that to them and charge them when you actually have to perform a service to get that information.

Then there's, of course, the 1033 we're making on open banking and the ability of outside parties to be able to access consumer information and the bank's ability to provide that to them through APIs and open interfacing networks and then where the liability shift goes once that information leaves the bank's possession. So, all these things are putting downward pressure on DDA pricing and then certainly can affect how we look at the cost proposition of a checking account, especially when they're free checking accounts and they obviously also take money to operate. But under this rule, the three choices are false choices at this point.

The application of Reg Z is something that it remains unseen if maybe a very large institution could do this, but I doubt even the largest of institutions in this country will be able to do this from a practical standpoint. It'll require all the provisions of Reg Z and then the disclosure requirements at point of sale for debit use. Then when you're using a debit card as pointed out earlier, it would be a hybrid credit-debit situation in which all the CARD Act provisions would apply as well, including things

like fee harvester provisions, which obviously could put a huge limitation on the ability for banks to even offer overdraft in the Reg Z context. So, it becomes a situation in which it's not a practical means of providing credit to consumers.

The Bureau believed that if you could underwrite these people, then you could underwrite into a credit program, but the fact of the matter is a lot of customers, banking institutions, may not be credit-worthy enough to be underwritten to a credit product as it stands already. A lot of banks have overdraft protection programs, which are separate from overdraft services as you probably know or lines of credit or links to a savings account or a credit card of some nature in which the consumer has options to cover an overage. Those consumers are credit underwritten into those products. The consumers are often offered those products first before overdraft services.

So, the folks that are going to lose out on this on a Reg Z proposition are going to be the folks that can't be underwritten into products in the first place and they will likely lose that service or that liquidity option. Whereas they have few other options in place to cover an emergency liquidity shortage. As we've seen a lot of data from the Fed and others, 60% of Americans can't even cover a $400 emergency shortage. So, this becomes a real issue about liquidity for those consumers at the lower end. The only other things I'll cover here are the two other options that were discussed, the benchmarking options and the breakeven option.

So, just on the breakeven option, the CFPB is instructing banks to consider only direct costs as Kristen mentioned, so those costs of charge-off losses specifically traceable to the provision of a non-covered overdraft credit in the previous year. Both of these methods exclude a lot of the direct costs that could be associated with overdraft programs, including handling of complaints, consumer contact centers, including call centers, branch services, or other consumer communications such as postage for mailing those types of issues, collections issues, automated charge-off and debt bureau reporting, those types of things that could be directly attributable to an overdraft program.

Plus, there are other operational costs that are out there including vendor services, compliance testing, technology development, checking cost to serve allocation. Those types of issues are real relatable cost to overdraft programs and most other activities that banks do that are not accounted for in either of the Reg E methods or exceptions to the Reg Z option. So, that's problematic to start with, but under the breakeven, the Bureau doesn't give a whole lot of direction about how this calculation is going to be made and it's going to be a year-by-year calculation.

There's going to be a lot of conversations between supervisory staff from the CFPB I would imagine and bank staff, but I would venture to say that a risk-averse institution would not employ this breakeven analysis when that analysis isn't really going to come with any real fee ability to recover cost for this product. That would be in best interest just not to offer the product under the benchmarks. I mean, again, I would just say that the Bureau comes up with the calculation for costs for these benchmarks that are very limited to a single set of direct costs or the allocation of overdraft. Again, it doesn't cover all of those issues that I discussed before.

So, the breakeven benchmarks, assuming that even went with $14, the highest benchmark proposed would likely not provide for that return that banks might need. If you're a larger institution, you may be able to scale it. We've seen Bank of America come in with a lower amount for an overdraft fee. They may be able to absorb those costs, their incentives may be very different. They want to keep consumers in those products. They want to keep consumers in their depositories. But I would venture to say it would take a very large institution to be able to scale those and absorb those losses through their portfolio and cover them through other products and services that they provide.

So, the net effect of this is I think you're going to see a large portion of our consumer population or customers or banking institutions or depository institutions lose access to overdraft services where they may not have access to other services such as credit cards, small dollar lending, and then be forced into the non-bank sector where they may not fare as well from a pricing perspective or even from a regulations perspective. So, covered a lot there, but John, let me turn it back over to you and go from there.

John Culhane:

Thanks, David. So, I'm briefly just going to add a few additional observations and a few comments about potential legal challenges. I think David's talked about the marketplace in good detail. So, one of the questions you have to ask is why is this rule even necessary? Aside from the fact that there's a State of the Union address coming up and this misguided attempt to

attack fees, it's really questionable if the CFPB has made the case for adopting a rule here. They've harped on this policy argument that times have changed and then a legal argument that the environment has changed. The policy argument basically makes no sense.

This is all driven by customer usage and it's no less a courtesy because customer frequency has changed in an environment where customers have the ability to determine what their account balances are. It's not the bank submitting instruments or submitting payment instructions. It's customers who see this as a convenience and want to take advantage of it and suggesting that somehow this is all different from the world of paper checks when customers likewise were afforded a courtesy I think is pushing the envelope a bit much.

There's a lot of talk here about closing the loophole, which is CFPB talk for this is just another situation where the Federal Reserve Board did stuff that caused the economic problems that resulted in our agency being created in the first place, as if that happened in a vacuum. In fact, the CFPB ignores the provisions of the Truth in Lending Act adopted as part of the Truth in Lending Simplification Act that essentially incorporated into the Truth in Lending Act, the provisions on which the current rules are based. The general rules for the definition of credit when there's no written agreement and the rules about how to determine whether a charge is a finance charge setting forth a clear exclusion that a charge is not a finance charge if it's a charge of a type payable in a comparable cash transaction.

So, this is not a regulatory loophole. This is a design of the Truth in Lending Act reflected in the terms of the regulation. I was going to say that it's also unprecedented to see size distinctions and amount distinctions adopted in a regulation where those make no sense, but the CFPB just did that with the credit card late fee rule as well. But I think it's certainly unusual and bizarre in this context to say that the same transaction is credit subject to Regulation Z with a large financial institution, but not credit subject to Regulation Z when the same product is offered by a small financial institution. Just as an aside, one of the questions we got is does this include credit unions when we reference banks?

Yes, it's banks and credit unions. It's all financial institutions over 10 billion in assets. Likewise, this notion that we can make a distinction and peg a dollar amount and say that if it's a breakeven fee, it's not a finance charge, doesn't align with the provisions of Regulation Z and the Truth in Lending and the staff commentary that expressly say that if you impose a separate charge to recover costs, even if that's a breakeven charge, that cost is a finance charge. So, really far-reaching distinctions being made here that just don't really make any sense in the context of the Truth in Lending Act and Regulation Z. Then lastly, the CFPB basically admits that it's imposing a rate cap.

There's a lot of talk about what the effective rate is on these transactions and the CFPB notes the potential collateral impact on small institutions including the imposition of state usury laws. Section 1027-O of Dodd-Frank prohibits the CFPB from imposing a usury limit, and that certainly looks like that's what they've done here. I think there are a lot of developments that are going to marshal the trade associations and institutions to challenge this rule pretty quickly. We're likely to see Chevron deference go away, and it's really hard to believe that this proposal is going to survive a challenge.

There haven't been a lot of comments on it to date, but I think it's noteworthy that there's one credit union comment from a smaller institution combined employees credit union that just notes the significant adverse impacts this is going to have on small institutions. I think we're going to hear more about that as we move forward and as there are challenges to the regulation. So, let me stop there. David, anything to add?

David Pommerehn:

Yeah, I mean, I'll just add a little bit. I mean, yeah, the bank credit union distinction, I try to say depositories but slip up because I often represent banks, but yeah, it affects everyone over 10 billion. Certainly, John, that's very arbitrary number that Bureau doesn't account for. I believe under TILA, they can exempt whole classes of credit but not based on asset size. So, I think that's going to be a challenge in itself. Of course, you covered the TILA challenge and the definitional challenges of credit that are in the act. I also point out that the benchmarks also seem very arbitrary and not allowing for true cost of overdraft products. I think there's an issue to be had there. I think you can argue around congressional attempt.

Congress has opened TILA a couple times over the last 50 years and have not changed these definitional issues, and I think that there's a real issue around congressional intent and they're acquiescing in the definition of exemption of overdraft from 1969. So, I think there's a lot to go on here. I'll also point out the Bureau itself back on the prepaid rule back in 2014, 2015,

agreed with the definition of overdraft on DDA, although they changed it in the context of prepaid. They agreed that the definition of DDA should be that it's not a written agreement to incur debt or to defer payment, and then situationally, it's not an exemption based on a currency overdraft but is in fact not credit under the definition of credit TILA. So, I just put those out there.

We're also fooling around with this issue of whether or not this is a violation of the Takings Clause from a constitutional standpoint and not allowing a reasonable rate of return on a product or service. There's a lot of case law out there on this generally involving utilities, but I don't see why it wouldn't be applicable here as well. I'm not saying it's a good theory. I just say it's a theory that's out there right now.

John Culhane:

I think we should turn to the NSF fee proposal. Kristen, I think you're up again.

Kristen Larson:

Yes, thanks, John and David. So, the justification for the NSF fee proposal again centers around the whole junk fee agenda, but the weird thing here is they're looking to prohibit NSF fees that are rarely charged on debit card transactions or person-to-person payments that are declined instantaneously or nearly instantaneously. Fees that are commonly charged for check and ACH transactions would not be covered by the rule. Part of what the proposal is the CFPB claims are taking a proactive approach to protect consumers, because financial institutions may decide to charge these fees based on the other changes for overdraft credit. They say that banks have previously increased fees when technology provided an opportunity.

So, essentially, unlike the prior rule, this is going to apply to all covered financial institutions and it borrows definitions from Reg E for prepaid account and covered financial institution. It bans the charging of any fees on a covered transaction, which is an attempt by the consumer to withdraw, debit, pay, or transfer funds for the mere account that is declined instantaneously or nearly instantaneously by the financial institutions due to insufficient funds.

So, essentially, it would be like a swipe transaction or like a Zelle transfer. I'm not aware of a lot of financial institutions charging for this, but this is what they're seeking to prohibit. It's unlike what we thought might be included with the multiple NSFB on free presentment. It was different than that. I'll turn it over to John to talk about the legal authority, because this is the more important piece of this rule.

John Culhane:

Thanks, Kristen. The legal authority here is basically the Consumer Financial Protection Act and both the general rulemaking authority granted to the CFPB under that act and then the special rulemaking authority granted to prohibit unfair or deceptive or abusive acts and practices by regulation and to include provisions in the rule intended to prevent those acts or practices. I think it's clear that this represents a preliminary determination by the CFPB that the imposition of an NSF fee in these circumstances takes on reasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs or conditions, the product or service.

More about that when we talk about observations of legal challenges, and oddly, the CFPB acknowledges that many consumers can instantly access their existing account balances, but nonetheless concludes that that's insufficient and that consumers initiating transactions that would incur NSF fees would generally lack awareness of their available account balance and would generally not understand or not know the material risks, costs, or conditions regarding their account, which seems to be a colossal stretch given disclosures and given that the consumer that does this once ought to expect that the same situation will happen again. But let me stop there and again turn it over to David to talk about business implications.

David Pommerehn:

Yeah, thanks, John. So, I mean, obviously, this is a solution in search of a problem. It feeds very nicely into the junk fee narrative from the administration. So, now you have a few items they can appoint to at the State of the Union address. You have a final credit card late fee rule, you have a proposed overdraft rule, and now you have a proposed NSF UDAP rule that I could almost guarantee you will be mentioned on Thursday at the State of the Union. This one's even more of a head

scratcher, because I know for a fact the members of my organization, the 70 largest institutions in the country do not do this. I'm pretty certain that most institutions out there, depositories do not do this.

The Bureau is clearly trying to preempt banks from doing this if they do away with overdraft, but it's simply, again, something that's not happening right now. It's obviously an expansion of their UDAP authority, but also again, defeated into this notion of a junk fee. The problems I see with it is that it could be extended, it's a slippery slope. I mean it covers instantaneous or semi-instantaneous payments such as debit card on transactions only. It leaves ACH and checks off the board.

But in a world where they could put out anything, and at this point we know they don't like NSF from a large standpoint, from an enforcement standpoint, they've done a lot of work here with the authorized positive, settled negative, and also other issues around return deposit items and things of that nature. But with the faster payments environment that we live in now and the push to ever increase the availability of funds through the faster payment system, I think semi-instantaneous or instantaneous could be expanded in scope to cover other areas that could be next in line here.

So, I think that there are implications down the road perhaps for products and services that could be affected by the proposed rule, but I see this more as just, again, feeding into the junk fee narrative, the ability to do that. If you look at the press release, it almost accuses banks of doing this while also saying they don't do this. So, it's a very convenient way for them to again, poke at the industry and make a big deal out of something that's not even occurring right now. It's more also of a play of solidifying their abusiveness authority. I think that you're going to see more and more of that coming down the road.

Even in the circular they posted recently around credit card reward programs and the ability to compare them and whether or not the folks that run these programs are in fact above board, these types of companies have been attacked in the past by the FTC on deceptive principles from a single UDAP authority at the FTC. But now the Bureau has now expanded in this context again, their abusiveness standard and their double UDAP under Dodd-Frank in conjunction with deceptive. So, they're really trying to, I think, expand and solidify or codify their abusiveness authority for going forward. But as a practical implication, this affects almost no product that a bank offers currently. So, there won't be much in the way of an issue there, but it's really what's hidden behind door number two that we worry about going forward.

John Culhane:

Thanks, David. So, let me again add a few observations and potential legal challenges. This is a bizarre reformulation of the abusiveness standard, and as I read the comments that the CFPB made, apparently, the abusive standard now is ignorance is bliss. You don't have to read anything. You don't have to pay attention to anything. You don't have to look at your statements. You don't have to look at your agreements. You don't have to check your balance. Anything goes. This almost seems akin to the CFPB saying that if a bank gives you a book of checks, you could keep writing those checks until you've used the last one.

Regardless of the amounts of the checks, regardless of the amount of money you've deposited in your account or may have deposited into your account, you can just keep going and it's just abusive for an institution to object to that. Talking about legal challenges, again, I think this is another rule that we're going to see challenged in fairly short order once it's effective.

A practice that virtually no institution engages in, it seems to me there's a preliminary question there as to whether the CFPB can fairly assess whether a hypothetical practice or a practice engaged by few institutions really can be determined to be abusive when we don't really know enough about the populations that are affected by that and to make assumptions about what happens and how those populations are affected just seems to be a very bizarre way to proceed. Again, I mentioned earlier that the CFPB's formulation is that there's an unreasonable advantage and a lack of understanding of material risks and costs, and those are just assertions with really no basis to support them.

There's no basis for the assertion that consumers generally lack awareness of their available account balances, that they aren't able to access those balances through telephone systems, online banking, mobile banking, and in-network ATMs. The notion that it's the bank's responsibility, not the consumer's, to keep track of how they've used the account to know the account balance, know the checks they've written, know the electronic payment authorizations they've initiated, again, seems rather bizarre in the context of an assertion that there's an unreasonable advantage or a lack of understanding. This is pretty basic math and the CFPB's repeated assertions that consumers don't need to balance their checkbooks or keep track of their transactions seems extraordinarily broad and overbearing to me.

Again, we talked about this before, the notion that there's no awareness of the material risks or costs in an environment where there are extensive disclosures about the fees that are associated with transaction accounts and statements about those transaction accounts, again, saying that there's a lack of awareness is elevating the principle that ignorance is bliss in place of the standards for determining whether an actor practice is abusive.

If we took this and applied it to the credit card late fee rule that just came out, this would seem to indicate that even though a credit card late fee is disclosed in the application disclosures, repeated in disclosures with the account agreement, disclosed on statements, and that making the monthly payment on time is something that is within the control of the consumer, the consumer doesn't have to read the disclosure in the account agreement, doesn't have to remember to have funds to make an on-time payment, and assessing a late fee in these circumstances is somehow an abusive practice.

Again, I think that's just absurd. The notion that fees are abusive because financial institutions have no reason to impose those fees other than to generate revenue is an assertion that the CFPB makes here about the fees really without any facts and an assertion that fees are abusive because they allow financial institutions to succeed in the words of the CFPB as a result of negative consumer outcomes is likewise absurd. It seems to be an assertion that there should be no consequences for negative conduct by consumers and that no fees can have any deterrent effects whatsoever.

Again, I think this is extraordinarily broad and overreaching that it's almost certain to be challenged. Time that happens, there's not going to be any Chevron deference, unlikely to be any Chevron deference to CFPB interpretations. I think both of these rules are likely to be successfully challenged before they go into effect. I'm going to stop there. David, anything else you'd like to add?

David Pommerehn:

No, I mean, I completely agree with you, John. I think the rules will both be challenged. I think there's more at stake with the overdraft rule, but this is certainly something that seems very arbitrary and capricious from the CFPB's authority standpoint. I'll just also point out that there's the Congressional Review Act as well. So, depending on the composition of the next Congress and whomever might be in the White House, I won't make any predictions, but there could be some challenges to all of the rules through the Congressional Review Act and whether or not they'll be successful.

I think the credit card late fee rule would have to fall within this Congress for CRA and it probably wouldn't be successful, but the two here would likely fall into next Congress. I think that there is a swing in some of the political ideologies and majorities. There could be some success there. But nonetheless, yeah, legal challenges are bound to happen in this space. It's an interesting new world because banks and their representatives tended not to sue the regulators, but just shows you how egregious the actions of this administration's heads of their agencies have just gone amuck and really have left the industry with no other choice but to challenge issues going forward. So, it's an interesting new time.

Alan Kaplinsky:

Kristen, I wanted to leave time for a question that got asked by several people because that's all we're really going to have time for, and the question is this. These two proposed rules only purport to cover the major banks that are subject to CFPB jurisdiction that are supervised by the CFPB. The rules don't propose to apply, and they couldn't propose to apply, I don't think, to other banks that are subject to supervisory jurisdiction by the Comptroller, the FDIC, the Federal Reserve Board. Do those smaller institutions, and really a lot of them are not that small, but do they have free rein to continue to do what they want or do you or John or David see problems for them as well?

David Pommerehn:

I mean, I can add my two cents, Alan. I mean, I think the overdraft rules clearly has a bifurcation. The NSF rule, I don't think, does have that bifurcation level. So, it would apply to all banks of all sides, the NSF rule. The overdraft rule, although it only applies to banks above 10 billion in assets size or depositories credit unions as well, it's going to put a lot of downward pressure on smaller institutions to compete in the market. So, I think that the question here is a need versus should situation. I couldn't answer that. I mean, obviously, there's going to be downward pressure on deposit account holders or issuing banks that it's going to be necessary for them to be competitive in the market, and it's a slippery slope.

The Bureau has signaled that they're going to monitor the market for overdraft, what smaller institutions are doing, but they could act on that as well. Who knows? But you won't be required to, but the CFPB can write rules for all size institutions that may supervised by OCC and the FRB and the FDIC, but the CFPB can still write those rules to behold them to it. But my guess is that small banks aren't going to be supportive or quiet about either one of these rule-making.

Alan Kaplinsky:

Yeah, no, I'm just wondering why it is that the CFPB didn't issue some joint rule-making that would've included all of the prudential bank regulators or I'm wondering if they went to the prudential bank regulators do that and they were turned down, because it just seems strange to me that the overdraft rule is only covering the really big boys.

David Pommerehn:

Those banks that have made the most changes of their overdraft programs, right, to help consumers make a cost. Yeah. It goes back to the political narrative here of getting a "junk fee rule" out before the State of the Union. Only way they could have done that with overdraft is to exclude smaller institutions and skip the required sub briefer process that they would've had to have conducted in order to get that rule out. I also think they understand that it's going to hit smaller institutions harder, so put them out.

Alan Kaplinsky:

One of the ironies, and I'm going to close with this comment, the whole brouhaha regarding overdraft fees began probably a decade or so ago with a whole slew of class actions that were filed all over the country in which the defendants were initially all the major banks, but eventually included probably most of the large regional banks and some community banks as well. The main challenge dealt with high to low processing of ATM and point of sale transactions, that was considered to be the main problem that the consumer advocates had identified with the overdraft programs. Yet that issue isn't dealt with at all, as far as I know, by anything the CFPB has done or anything the prudential bank regulators have done. Instead, they have painted with a much broader brush, I guess you could say.

My thanks to our speakers today, John Culhane, Kristen Larson, both at our firm, and our very special guest, David Pommerehn, who is Senior Vice President and Associate General Counsel of the Consumer Bankers Association. To make sure you don't miss our future episodes, subscribe to our show on your favorite podcast platform, be it Apple Podcasts, YouTube Music, Spotify, or wherever you listen to your podcasts.

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