Consumer Finance Monitor (Season 6, Episode 29): What the Biden Administration's "Junk Fees" Initiative Means for the Consumer Financial Services Industry: A Look at the Fees Under Attack, Part II

Speakers: Alan Kaplinsky, John Culhane, Kristen Larson, and Michael Gordon

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 podcast show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm, and I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now a senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I'm very pleased to be moderating today's program. For those of you who want even more information, don't forget about our blog, which also goes by the name of Consumer Finance Monitor. We've hosted the blog since July 21, 2011 on the very same date that the CFPB became operational. There is a lot of industry content there. We regularly host webinars on subjects of interest to those in the industry.

So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com. If you like our podcast, please let us know about it. You can leave us a review on whatever platform you use to access your podcasts, be it Apple, Google, Spotify, or any other platform. Also, please let us know if you have any ideas for other topics that we should consider covering or speakers that we should consider as guests on our show. So this is part two of the repurposed webinar that we did a short time ago where the focus is on junk fees and the title of the webinar was called What the Biden Administration's Junk Fee Initiative Means for the Consumer Financial Services Industry, a look at the fees under attack. Last week, we talked about credit card, late fees, the proposed reg of the CFPB pertaining to credit card late fees, and we talked about what the CFPB and the other agencies have had to say about deposit account fees in particular overdraft and NSF fees.

And we were pleased last week to have John and Kristen go into detail on those subjects. If you missed last week's episode, make sure you download it because it really is a companion to the podcast show that we are doing today. So John Culhane has practiced with me for a longer period of time than any of my other colleagues probably going back upwards of 30 years or maybe even longer than that. And he is an expert in a wide range of topics pertaining to consumer finance, and junk fees is no exception to that. And then Kristen Larson is back again, and she is one of the newest people to join our group. Joined us last year after many years of being in-house counsel at a couple of fairly large regional banks in the Midwest. And joining us today also is another speaker, Mike Gordon. Mike also joined us last year, came to us from another law firm, but prior to that, spent several years at the CFPB as a assistant to and an advisor to the then director Richard Cordray.

So Mike has a lot of insight about the CFPB. So the way we're going to proceed today is that Mike is going to cover CFPB supervisory and enforcement activity related to deposit taking and auto servicing. Kristen will cover mortgage servicing. John Culhane will cover payday and small dollar lending, student loan servicing, and debt collection. And then Mike will discuss some observations he has that are pertinent to this junk fee initiative of the Biden Administration and the CFPB. And then at the tail end of our webinar today, I will attempt to provide a legal framework that we have used at Ballard Spahr and our clients who have come to us asking for help in deciding what's a junk fee and what's not a junk fee because they want to be on the right side of the law when the CFPB becomes knocking very often for an examination.

And I will provide a legal framework something that CFPB has not done, and I will frame it not so much as what's a junk fee or what's not a junk fee, but rather what's lawful and what's not lawful. And it's a multi-step process that we go through where we look at each product offered by our client, be it a bank or non-bank, and then we go through the process of determining whether the fees they are charging or want to charge are lawful or unlawful or if they're in a gray area, and if they're in a gray area, are there changes that could be made to make it not objectionable to the CFPB? So now let me hand it over to Mike.

Michael Gordon:

There's been a lot of activity in the auto space with the CFPB as well as the FTC, but for the moment I'm going to focus on a few types of fees in the auto servicing realm that were called out by the CFPB in a recent publication supervisory highlights because it's a helpful summary for the different categories of fees. And then I'll add a few thoughts at the end. So the examples that show up as supervisory highlights for those who aren't familiar with the process are things the bureau has discovered in the course of confidential supervisory exam, wants to alert industry and the public to, without naming the individual companies. These examples can be one-offs. They often describe the things they're finding as one or more examples of the following conduct, and it's hard to tell if it's a single example of a company making a particular practice or a mistake or whether it's more widespread.

But nonetheless, it does tell us what the bureau's trying to communicate with regard to its concerns more broadly. So with that, one example that they highlighted recently has to do with the notion that late fees that may be authorized by contract were charged in a way that exceeded the authorized amount. And here the specific example they gave was a system had been programmed to charge a $25 late fee. The contract, however, capped the late fee at 5% of the monthly payment, and therefore the $25 fee could in some cases exceed that. And this was deemed both an unfair and deceptive practice by the bureau.

Another example regarding late fees had to do with backend, the repossession context where a loan is delinquent is being accelerated for delinquency. And at that moment, as the bureau explains it, the acceleration of loan balance eliminates the consumer's obligation to make further periodic payments. And a late fee that contractually would've been tied to a periodic payment that's late then the servicer no longer has the contractual authority to charge such a late fee. And therefore in this case, the servicer was charging a fee, a late fee at that late stage, and that was considered to be unfair or deceptive as well. In this case, as in some of the others, they required refunds of any such payments that were made and on both these examples underscore the importance of regulated entities carefully queuing to the contractual language they've laid out and making sure that their operations are consistent with the contractual limitations.

And the next example has to do with repossession. And here the practice which was objectionable or cause harm according to the bureau was an estimate, an estimated fee approach. In this case the conduct that the fee that's being estimated is the cost of the repossession that the repossession agent charges back to the servicer. And what happened is the servicer would estimate that fee and charge it, and then when the actual invoice comes from the repo agent, they would refund any excess amounts back to the consumer. Now at first blush, that might sound like a kind of no harm, no foul circumstance if the consumer's being refunded, but that's not at all how the bureau sees it. And I would say the facts were rather extreme in this case, since I think allowed for the bureau to attack this practice of estimation. It was deemed an unfair practice.

And the basis for that was really twofold according to how the bureau described it in their publication. First, obviously the customer is deprived of the short term benefit of the use of those funds while they're waiting for the refund of the overpayment. But also the overpayment was so significant that it may have dissuaded customers from of course the conduct they would've otherwise taken to, for example, try to recover the vehicle. So according to the bureau, there was a very large disparity between what the service cost and what the estimated fee was, the difference between an average of $1,000 of the estimated cost versus actual cost being closer to 350. So that to me strikes me as a pretty extreme and pretty large variance. Again, something which servicers have the ability to monitor and adjust if they do feel the need to use an estimation approach.

But this kind of lesson can be learned for any context where estimation is used as a method of imposing a fee, and it's worth highlighting the bureau's skepticism of that approach and the reasons for it. Finally, a final fee that the bureau talked about recently is payment processing fees. And we see that we've seen this in lots of contexts and lots of industries, the so-called pay to pay fee or convenience fees have been a repeated subject of the bureau. In this case, in the auto context, there was concern about the practice of charging payment processing fees that far exceed the servicer's costs for processing payments and doing so was deemed unfair and abusive. And you'll recall what Alan told us at the beginning of this webinar. The bureau can't regulate interest rates. Well, they also explicitly don't have a statutory authority to regulate the size of fees.

However, when they find, as they did in this case, a fee that greatly exceeds the actual cost to the service provider, they are not going to be shy about scrutinizing that fee. And in this case, they're going to look at other contextual facts to see if they can build a UDAP theory based in part on the size of the fee. So in this case, some of those other contextual features were that there were limited in the bureau's mind choices for how you would pay, and that resulted in 90% of payments requiring the occurrence of a fee. So whereas, if there had been many options with no fees and a smaller percentage, perhaps the bureau

wouldn't have reached the same conclusion about this disparity between fee and actual cost. But in this context, it all kind of built to a concern about consumers being basically unable to avoid a fee that the bureau found to be excessive.

A couple other things to note about the bureau and their interest in fees in auto space is that they've been very focused in recent years, the repossession process, and we can expect that to continue as delinquencies continue to rise in the auto finance space. So other issues they've addressed include property return fees. If there's property within a car that had repossessed, does the consumer have to pay a fee in order to get that property returned? Is that fee going to be scrutinized for a potential UDAP violation? Also, front end fees that can be front end products like voluntary protection products that can be purchased at the time the loan obligations incurred can lead to fees down the road if someone, for example chooses to cancel, there can be cancel fees. And that's another area that bureau has scrutinized. And it's not just the bureau, the FTC has had a lot of recent pronouncements on fees including in the auto space, and they have a proposed rule that would address fees in how certain products are sold.

And in addition, they've had enforcement activity. One thing that jumped out at me was enforcement matter FTC brought having to do with fees for certifications like this is a certified inspected or reconditioned car. And the allegation in that case was that the dealer claimed these charges were required when in fact, at least in some instances they were prohibited by the auto manufacturers. We've seen CFPB enforcement activity as well in this space, and we expect to continue to see that going forward. With that, I'll hand it back to Kristen to discuss mortgage servicing.

Kristen Larson:

Yeah, so similar to some of the other areas, late fees of course remain an issue, charging amounts that exceed the amounts allowed under the loan agreements, charges for repeat property inspections to known bad addresses, mortgage insurance premiums charged when the policy was either lender paid or should have been terminated. Fees that were not waived after the Cares Act forbearances specifically on FHA loans when HUD specifically required the waivers, late fees that were charged when the periodic statements disclosed that there was a $0 late fee. So it's kind of the similar trends we've seen with the other products. With that, I'm going to turn it back to John to talk about payday and small dollar lending.

John Culhane:

I'm going to talk fairly quickly about payday, small dollar lending, student loans and debt collection so that we have an ample amount of time to talk about next steps in terms of supervision and enforcement and for Alan to return to his analytical framework. So payday and small dollar lending, two of the fees here that are mentioned are ones that Mike mentioned in connection with auto finance practices. In here, they're coming up in the title loan context, fees to retrieve personal property from repossessed vehicles, and then repossessions that occur and result in fees being assessed despite payment arrangements that were promoted as allowing consumers to bring their accounts current and avoid repossession.

The splitting representing payments is an interesting and somewhat novel theory here by the CFPB. What they asserted is that small dollar lenders, payday and small dollar lenders without disclosing or without any express authorization from consumers, which sort of begs the question as to whether those are needed, could split a unpaid payment that was outstanding after an unsuccessful debit attempt into smaller components and then try to collect pieces of that entire amount until the entire amount, until the whole amount is collected.

That's not a fee itself, but in the minds of the CFPB, that's a practice that could lead to fees. It's not clear whether it actually did lead to fees, but because it could have resulted in multiple overdraft fees, the CFPB found it objectionable. There's an interesting comment here that I just want to note because I think it's one of the few times the CFPB actually articulates a theory that's behind a lot of its activity with regard to payments. And they made it clear that one of the consequences here that they didn't like was that this deprived consumers of the ability to prioritize their payment decisions by sort of nibbling away at amounts that were in the account rather than having the whole payment rejected for insufficient funds. We go from here to student loans. As you may notice here, we're now talking about a lot of fees that are according to the CFPB, not authorized or maybe assessed as the result of mistakes.

And that lack of clear authorization or that mistake in practice somehow transforms a fee that might otherwise be valid and legitimate in the minds of the CFPB into a junk fee. In the case of student loan servicing, the alleged practice was charging late fees and interest after reversing payments that were accepted. And in particular this happened in the context of credit card

payments accepted by customer service representative erroneously when the holder's practice it was not to accept credit card payments, then reversing those fees and charging late fees without giving the consumer the opportunity to come back in and make a conforming payment. And in some cases the CFPB asserted that there really were no measures in place to prevent these payments in the first instance and in other situations that notices were late and deficient.

In terms of debt collection, this is the fee Mike mentioned earlier, the convenience fee or the expedited payment fee. And here the attack on the fee is not so much the dollar amount of the fee, but the lack of authorization to collect it as a result of the CFPB interpretation of the Fair Debt Collection Practices Act, which prohibits the collection of fees unless they're expressly authorized by the agreement creating the debt or permitted by law. And the nuance here is that the CFPB really interprets this strictly expressly authorized means written into the agreement and permitted by law doesn't mean not prohibited if likewise means expressly authorized. Let me stop here because I want to turn it back to Mike for some observations on potential developments at the CFPB and then in turn to Alan to talk about the analytical framework for determining what is and isn't a junk fee.

Michael Gordon:

Thank you, John. So to take a higher level view of this whole junk fee initiative, I think it's interesting to observe the very close level of coordination between the White House, the CFPB, and other agencies. And I worked at the CFPB for the first five years of that agency, and this exceeds anything that we would've done during that timeframe. And I think it's a harbinger of things to come. It's not going to be the last time that White House and administration wide priorities can be seen to so directly impact CFPB priorities. And that's a natural result of a constitutional law decision about the bureau structure that happened a few years back, which the gist of it was the director needs to be removable by the President at will rather than for cause.

It sounds like a small thing, but what undergirds that kind of decision is that the Bureau may consider itself an independent agency, but it can't be that independent. It needs to be closer to the White House and the President who runs the executive branch needs to have more direct control. And a natural result of that is more communication and more coordination on policies and priorities. And so I view this junk fee government-wide initiative as one of the examples of that new closeness between the Bureau and the White House.

In terms of what's to come, there remain incentives at the Bureau for less rulemaking and more use of other tools. And the Bureau has been very creative under Director Chopra to use every imaginable tool that they have. And so I do think we're going to continue to see fees come up in a number of ways through the different types of pronouncements the Bureau has. I'm going to list a few of these, but every single one of these has been used by the Bureau to address fee issues just in the last year. Supervisory highlights documents, guidance, circulars, advisory opinions, bulletins, these are all not binding in the way that a rulemaking is, but ways for the Bureau to communicate its priorities and its views on the law and that are short of actual notice and comment rulemaking. And we'll continue to see the Bureau using those tools. Those are easy tools to implement.

They can get out the door quickly, and they don't require a long-drawn-out process that rulemaking does with all the attendant resources. They will on occasion probably use rulemaking. The most notable is the one John already outlined for us, which is the credit card rule. In terms of what we might see coming down the pike on that rule, I think it's fair to expect a significant delay even once that rule becomes final before it's implemented because there is such substantial opposition to it. A legal challenge is almost assured. And in this context, not only would there be potentially strong grounds to challenge the rule itself that could lead to drawn out litigation, but there's an additional delay that could occur here because of another constitutional overhang, which is a pending Supreme Court case right now that the Supreme Court has agreed to hear in the fall and for which we probably won't get a decision till next calendar year that has to do with the CFPB.

That case has to do with whether the funding mechanism for the CFPB is constitutionally valid. And the stakes are quite high because if the Bureau loses that case, it couldn't spend a single dollar doing anything, writing rules or enforcing laws or anything else unless Congress were to repair the funding mechanism. And so in some active litigation that's occurring now on other issues, judges are staying decisions and staying those cases until they know the outcome because the litigation may turn out to be moot if court rules against the Bureau. So I mention that only because there may be similar challenges to the credit card rule on that ground among others that could lead to an extensive delay before there would even be a ruling on the validity of that rulemaking. And of course, in addition to the credit card rule, it's possible that the Bureau may revise other existing

rules that relate to fees or disclosures and where it has the authority to do so, the instances of which fees can be assessed and the amount of such fees.

But like I said, I'm quite confident we'll see more policy pronouncements and fewer rulemakings. And so I'd be surprised if we see more than a handful of even modest rulemaking efforts around fees. Public enforcement is another favorite tool of the Bureau. We have seen that in ways that we've already discussed in this webinar. We will continue to see it. And one thing I would point out about that is that in looking at how past enforcement actions have been structured, we can see that sometimes the Bureau disfavors a certain consumer financial product or service but can't make a frontal attack on it because it comports with law, but they have reasons to be suspicious or to disfavor it. And they look for ways in the door to challenge indirectly the practice they really don't like. And oftentimes, that can be a fee if a fee is inappropriately charged or there's a mistake in the administration of fee or collection activity, or even upfront disclosure activity or marketing and deception allegations.

The Bureau will look for ways to engage with the providers of those services based on mistakes or violations that occur in, for example, the fee implementation, but then use the opportunity to criticize the underlying product or service. And I wouldn't be surprised to see that continue as we've seen in the past. And another sort of big picture point to make here is backend fees that relate to collections payments are going to be increasingly scrutinized by the Bureau due to the macroeconomic changes. At any time when delinquencies rise in consumer finance markets, the Bureau is going to be focused more on collections issues in an attempt to protect consumers from unfair practices on the backend that can have significant consequences. And in addition to the Bureau, as has been noted earlier, other prudential banking regulators, the FTC, state regulators and of course plaintiff's attorneys are going to continue to be focused on fee issues. They've been activated on these issues, and I don't expect that to cease anytime soon. With that, I'll pass it back to Alan for some additional remarks.

Alan Kaplinsky:

So I'm a bit tired of hearing the Biden Administration and most notably the CFPB's inflammatory rhetoric about junk fees. And this has been going on now for well over a year. What's noticeably absent as again, I pointed out my opening remarks from any of their rhetoric is any mention of whether a fee is lawful or unlawful. To me, that is the touchstone. It's not whether the CFPB wants to categorize something as a junk fee. The best example I can give you of their indiscriminate use of that term is saying that credit card late fees are junk fees when even the CFPB would admit that credit card late fees are authorized under the CARD Act, which predated Dodd-Frank and the creation of the CFPB, and that there are regulations issued initially by the Federal Reserve Board and then inherited by the CFPB authorizing certain credit card late fees and creating a safe harbor.

Now, CFPB admittedly is trying to dramatically overhaul their existing regulation dealing with credit card late fees, but that hasn't happened as yet. And they're not going to make them completely unlawful. I don't think, although that is one of the things that actually they mentioned in their supplementary information that accompanied their notice of proposed rulemaking. So credit card late fees clearly are authorized as a matter of federal law. They're authorized as a matter of state law. Their disclosure is mandated by the Federal Truth and Lending Act, and yet they are referred to frequently by President Biden in his State of the Union message and by the CFPB as junk fees. So I think using that label doesn't get you terribly far.

Their indiscriminate use of the term junk fees has created what I consider to be a dire need for an analytical framework that the industry can use to identify which fees are likely to be considered lawful or unlawful by the courts and by the CFPB and the Federal Trade Commission and the federal banking agencies, even though they haven't yet jumped on this junk fee bandwagon. So let me run through this framework. The first question, and this is what we have used. We've used this framework for several clients who have come to us and some of them in a panic because they've heard that the CFPB doesn't like certain fees, and they fear that they may be charging fees that the CFPB doesn't like. And they don't want to be put in a defensive position when the CFPB next comes in to do an examination.

So we caucus in our consumer financial services group, and we put together the following framework. The first thing that you look at is whether the consumer agreement, to the extent that an agreement exists, provides authority to charge the fee, whatever kind of fee it might be, doesn't necessarily have to be in the original agreement. It could be an agreement entered into after the initial agreement between the consumer and the lender. But there's got to be an agreement. If there's no agreement to charge the fee and you charge it, then not only are you going to run into trouble with the agencies, but you'll be sued for breach of contract. And you very well might get sued in a class action. The next question, after you have determined

that there is an agreement authorizing the fee, you next need to determine is there express or implied authority under federal or state law to charge the fee?

And you need to pay particular attention to state laws that provide that unless a fee is expressly authorized, it may not be charged. And also you need to determine the role the federal preemption may play in your analysis because if the fee is not permitted under state law, that doesn't necessarily mean that you can't charge the fee if there is some kind of federal preemption that might apply. And the federal preemption could relate to exporting interest rates under the Marquette doctrine and under Supreme Court precedent Smiley versus Citibank, it's not only periodic interest that is exportable. You have to look at how interest is defined as a matter of section 85 of the National Bank Act and Section 521 of the Depository Institution's Deregulation of Monetary Control Act of 1980. So that's the second thing you look at. The third thing you look at is what is the business rationale for charging the fees? And is it a sound rationale?

That's probably one of the more difficult inquiries that you need to make. And there's so many permutations and combinations that we certainly don't have time to get into the detail today about that. But that is an inquiry that we think is important. Then, is the fee clearly and conspicuously disclosed at the account opening to the extent that the charging of a fee is contemplated at that point sometime during the life of the relationship between the consumer and the lender. So there you've got to determine whether there's been compliance with the Truth and Lending Act, if it's a loan transaction, the Electronic Fund Transfer Act or the Truth and Savings Act, to the extent that any of those three statutes are applicable. But you may need to go beyond that. There may be other things that you need to do, particularly if you're dealing in an online environment to make sure that you aren't, to use another term used by the FTC, engaging in a dark pattern, hiding the fees in some fashion where it might technically comply with TILA, FTA, or TSA, but may be a deceptive act or practice.

Then the next thing to look at is whether or not the fee is one that the CFPB has already found to be unfair or abusive and authorized positive, settle negative would be a good example of that that Kristen mentioned, or NSF fees. In that situation, even though you could at least theoretically put in your agreement a clear disclosure that you're going to charge those kinds of fees, we already know that the CFPB doesn't like the fees to be charged. And unless you enjoy getting into a Battle Royale with them, the better part of valor is not to charge those kinds of fees.

And then if we do find or you find that a fee would be considered unlawful by the CFPB or the FTC, and it's not necessarily the end of the inquiry because then the final question is, what changes, if any, can be made to avoid a UDAP finding, such as changes to when the fee is charged, the amount of the fee, or how it's disclosed? And that is basically the framework that we have used, and it should be used for every consumer financial services product you need to identify for each product that your client is offering.

You really need to catalog the fees that are being charged, the circumstances under which they're being charged. And then it's important to go through this process to have a lawyer, your outside counsel or in-house counsel, deploy this analytical framework. Now, there may be other things that could be added to the framework, and this is just what we have come up with at Ballard Spahr. And it doesn't necessarily mean that the CFPB would agree with how we analyze it, but we felt that we had to do something here because we couldn't really help clients by just looking at the various definitions that the CFPB has used for more than a year since it got on this crusade against junk fees.

So we have come to the end of our program today. And I want to thank Kristen, John Culhane, and Mike Gordon for doing a terrific job during our podcast show today. So to make sure you don't miss our future episodes, subscribe to our show on your favorite podcast platform, be it Apple Podcast, Google, Spotify, or wherever you listen. Don't forget to check out our blog, consumerfinancemonitor.com for daily insights on the consumer finance industry. And if you have any questions or suggestions for our show, please email us at podcast@ballardspahr.com. And stay tuned each Thursday for a new episode of our show. Thank you for listening, and have a good day.