

Consumer Finance Monitor (Season 6, Episode 28): What the Biden Administration's "Junk Fees" Initiative Means for the Consumer Financial Services Industry: A Look at the Fees Under Attack, Part I

Speakers: Alan Kaplinsky, John Culhane, and Kristen Larson

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, particularly about the subject that I'm going to introduce to you in just a couple of minutes, which we will be focusing on today. 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 today, we're going to be repurposing a webinar that we did not very long ago that was entitled What the Biden Administration's Junk Fee Initiative Means for the Consumer Financial Services Industry: A Look at the Fees Under Attack. And this is going to be a two-part podcast, and we're going to have two speakers today, actually three, because I will be one of the speakers, and I will be leading off. And then we're going to have John Culhane who will discuss the credit card late fee proposal because, believe it or not, the Biden administration and the CFPB considers a late fee, which is completely lawful under the Federal CARD Act, and which is contracted for and properly disposed under the Truth in Lending Act to be a junk fee. So we need to focus on that, and John Culhane will be doing that. No need for me to provide you with additional biographical information about John other than to say he has practiced with me for a longer period of time than any of my other colleagues. And he is very knowledgeable about a wide range of topics, including the topic of today, namely junk fees.

And then, after John is done, then, it'll be up to Kristen Larson, who is one of the newer lawyers to join our Consumer Financial Services Group. Kristen was in-house for many years at a couple of regional banks. And her area that she focused upon was deposit account fees. So, therefore, it makes sense that Kristen would be our expert today to talk about deposit account fees, including overdraft and NSF fees, and she will provide you with what you need to know about those particular fees.

And now, I'm going to tell you begin the program with what is a junk fee, at least what has the CFPB, the Federal Trade Commission, the other regulators, and the Biden administration, how have they defined junk fees. And they've done it in a lot of different ways. So I did a little extra research to try to find out if I could find anywhere a definition of a junk fee before the use of it started, I believe, in January of 2022 by Rohit Chopra, the CFPB. And as much as I could look and I looked on online dictionaries, I looked at other sources on the internet and other than articles written about what the CFPB and the CFPB have done, I was unable to find any definition of the phrase or term, junk fee. Also, it should be noted that term was not contained in the Dodd-Frank Act. It was not contained in any part of it, including, most importantly, the Consumer Financial Protection Act, which is the main statute under which the CFPB operates. There is, of course, in the Dodd-Frank Act and the Consumer

Financial Protection Act, a lot of items pertaining to UDAAP, unfair, deceptive and abusive acts and practices. And, of course, that's really what the CFPB is hanging its hat on here.

What it's saying basically is when we call something a junk fee, that means that we think it's either an unfair, deceptive and/or abusive act or practice. I really think what it really means is it's a fee charged to a consumer that Director Chopra doesn't like for one way or another. He can't do anything about interest rates. I know he doesn't like high interest rates. He said that on numerous occasions, but he's hamstrung there. Fortunately, Congress prohibited him through language in the Consumer Financial Protection Act from doing any regulation of interest rates on consumer loans or consumer credit, but they didn't say anything about fees. It's too bad they didn't. Then, we wouldn't have to go down this rabbit hole that he wants to send us to go down. And so he has taken that as an invitation to regulate fees to the greatest extent that he can.

Sometimes, he's got clear statutory support for that. Not very often he does with respect to credit card late fees under the CARD Act. But in most other instances, the fees that he doesn't like and that he is called out are not fees that are mentioned anywhere in any of the statutes over which he has authority to regulate. And, of course, he doesn't regulate. He doesn't like to regulate unless he has to. With credit card late fees, if he wanted to change anything, he had to issue a regulation, didn't have any choice. But when it comes to these other fees, he is basically going back to the usual way in which he provides advice to the industry. And that is through circulars and guidance and blog posts and speeches, et cetera, et cetera, et cetera. But he does not do it through regulations.

So let me just run through these very quickly. The first two items, hidden backend fees that are mandatory or quasi mandatory fees added at some point in the transaction after the consumer has chosen the product based on a front-end price, or inflated or surprise fees that are not meaningfully avoidable or negotiable. That comes from the initial document that the CFPB issued regarding junk fees, a request for information dated in January of 2022.

The next item, fees designed either to confuse or deceive consumers or to take advantage of lock-in or other forms of situational market power. That comes from the White House Initiative regarding junk fees that got launched in October of 2022. The White House soon figured out, didn't take them very long to figure out, that a crusade against junk fees would be a nice campaign issue for the 2024 presidential election.

And before we knew it, President Biden made a presentation, an online streaming presentation, wasn't on TV during which he was flanked by Rohit Chopra on one side and Lina Khan, the chair of the FTC on the other side. And he targeted not just fees charged by the consumer finance industry, but also fees charged by ticketing companies for sporting events and entertainment events, hospitals, doctors, airlines, and other industries as well.

And then, of course, that was followed up in January of this year by his State of the Union message where he spent several minutes calling out junk fees. And he again referred to several industries, but his focus was clearly on consumer finance. And he mentioned specifically overdraft fees where he takes credit for saving consumers over a billion dollars and the late fees on credit cards where he made it sound like it was already a done deal when, of course, it hadn't. It had just begun. So that is the third item on this list.

The fourth and the fifth item come from the special addition of supervisory highlights devoted just to junk fees, unnecessary charges that inflate costs while adding little to no value to the consumer, or unavoidable or surprise charges that are often hidden or disclosed only at a later stage in the consumer's purchasing process or sometimes not at all.

And the final item, any unnecessary, unavoidable or surprise charge that inflates a product or a services price while adding little value to no value. That came from a speech given by Zixta Martinez, CFPB deputy director. The most recent CFPB definition and the only one I'm really going to spend any amount of time on because it would take literally an hour and a half to go through everything they've said about junk fees, but this is the most recent thing.

And interestingly enough, it was testimony given by a senior advisor, not somebody who's terribly senior. I mean they're somewhat senior. They have in their title senior advisor, but it wasn't any deputy involved. It was not Zixta Martinez, a deputy director. And it was in testimony not before Congress, but before a committee of the Pennsylvania House of Representatives, of all things. And it was done on April 11th. And he sort of combined threads from other things the CFPB has said about junk fees, any unnecessary, unavoidable or surprise charge that inflates prices while adding little or no value.

A common feature is that they're all part of the price of the product, masquerading these fees in order to shield it from the competitive process. It's often buried in fine print or never disclosed at all. It can obscure the true price of products and dilute market competition, and it sometimes purports to be a fee for an add-on product, but an add-on product that is useless.

So moving ahead, these are examples of junk fees that come out of the various documents that they've issued in speeches. I'm not going to repeat all of them because my colleagues are going to get into that in a lot more detail.

This is more information about the RFI. That was the first issuance dealing with junk fees on January 26th, 2022. And there, the focus was very much on deposit account fees, ancillary fees, and the mortgage closing process was something else that was singled out. And then the FTC joined the bandwagon. They were sort of forced to join the bandwagon. I can't say they were unwilling to join it, but they announced an issuance of an advanced notice of proposed rulemaking on October 20th, 2022 seeking public comment on the harms stemming from junk fees and associated junk fee practices, and on whether a new rule would better protect consumers including the use of digital dark patterns or other deception to collect on them.

So it's interesting the way the FTC, which talks all the time about dark patterns. They invented that phrase, I think, although I think they did borrow it from some earlier source, but they were the first agency to start talking about dark patterns.

And in their ANPR, they talk about that and fees and how the two things combined, junk fees and dark patterns, to create unfair and deceptive acts or practices. They operate under Section 5 of the Federal Trade Commission Act. They do not have the abuse of prong to hang their hat on.

We haven't heard anything more. There has been no notice of proposed rulemaking by the FTC in this area. What they have done is, last year, they issued a proposed Motor Vehicle Dealers Trade Regulation Rule. And in that rule, they address what they consider to be unnecessary add-on fees that are involved in the car-buying process. They seem to have particularly targeted gap coverage or gap insurance.

And the final thing I'm going to talk about are the supervisory highlights, the special edition on junk fees, which is a must read for all of you. And it covered examinations done between July 1, 2022 and February 1, 2023 in the areas of deposits, auto servicing, mortgage servicing, payday, small dollar lending, student loan servicing, and fee practices. And that's where my colleagues are really going get into the weeds.

This release coincided with the virtual White House event for state legislators on state efforts to address junk fees. And also, the White House's released a guide for states cracking down on junk fees to lower costs for consumers. And then, the final thing I'm going to say is this affects all consumer finance products. There aren't any that are excluded even though the focus is largely so far been on deposits and credit cards, but it really covers everything under the sun. And with that, I'm going to turn it over to John who's going to bring us up to date on the credit card late fee proposal.

John Culhane:

Thanks, Alan. So, yeah, we're now going to talk about credit card late fees, which Deputy Director Martinez described as the fee that has skyrocketed from a small corner of the market to the top of everyone's most hated junk fee list without acknowledging the tremendous support, encouragement, and rhetoric from the CFPB to make sure that it skyrocketed to the top of the list.

But let's start with a little bit of a backstory here. You probably recall that the CARD Act gave the Federal Reserve Board the discretion to establish safe harbor amounts for penalty fees, including late fees. And the safe harbor was initially set at \$25 for a first violation and then at \$35 for a subsequent violation in the next six months. I think that's going back to 2010. There were annual adjustments for inflation thereafter up to 2021. And the CFPB announced these adjustments regularly at the end of each year.

And at the end of 2021, for 2022, they announced adjustments to a \$30 fee for the first violation and a \$41 fee for subsequent violations. So over the course of roughly 12 years, 13 years, the fee for the first violation went up a whopping \$5, and the fee for the second violation went up a whopping \$6.

That might not seem like a lot to you, but it apparently caught the attention of the CFPB and Director Chopra because, beginning in 2022, they launched into their standard operating procedure for taking action against practices they dislike. Rhetoric from Chopra followed by a pejorative report on credit card late fees came out in March of 2022, characterizing them,

and harkening back to Alan's comments earlier, as basically a major source of revenue noting that major issuers charge maximum fees, and then criticizing the assessment of these fees and who was required to pay them, noting that they were very common and conspicuously more on a percentage basis in the subprime and private label credit card markets and had, according to the CFPB, a greater adverse impact on low income consumers, consumers residing in majority African American areas, consumers at lower economic hard places in the marketplace, but they all paid more.

And then in somewhat surprising assertion, the CFPB asserted that you could tell from the way that stimulus payments affected late fees that, in fact, late fees provided no meaningful deterrence, had no meaningful incentive on consumer payments. It's not entirely clear to me how you get there from observing the fact that when people have more money to spend at a time when people weren't spending money and they paid their credit card bills and they were going to incur late fees, but somehow there was no deterrent effect. But that was the conclusion CFPB reached.

So we move along. And then there's a Chopra blog post in June calling for fresh look at credit card late fees. There's a publication in Advance Notice of Proposed Rulemaking asking for comments about junk fees and credit card fees.

And we wind around to the end of 2022. We get to December, and there is radio silence from the CFPB, although I guess it's not surprising at this point given what preceded it. And so we get to December. The CFPB fails to announce an annual inflation adjustment for credit card late fee safe harbor amounts. And instead, it segues into a rulemaking proceeding.

And in February, the CFPB issues a notice of proposed rulemaking calling for substantial reduction in the safe harbor amounts, the elimination of annual inflation adjustments, and other significant changes in the rules for credit card late fees. That notice of proposed rulemaking was published in the Federal Register on March 29th of this year. Comments were due May 3rd. There are roughly 225, 226 comments submitted. We'll talk a little bit about those in a minute.

The major feature of the proposal obviously was that it proposed to reduce the safe harbor dollar amount for credit card late fees to a maximum \$8 amount that would not be subject to an annual inflation adjustment. And then pretty dramatic increase from where we were in 2010 with a \$25 late fee that the Federal Reserve Board felt was entirely justified.

So a little bit more about this proposal, the safe harbor for late fees is actually the lesser of \$8 or 25% of the amount of a delinquent amount, which typically would be the minimum payment. So if the minimum payment were \$30, you wouldn't be able to get the \$8. You would be stuck with a safe harbor of 25% of 30, or \$7.50. So that's both a change in the calculation and a limitation on the amount based on the size of the minimum payment amount.

Fees based on costs were left alone in theory leaving issuers the option to determine that late fees that they would assess were reasonable and proportional, and to move to those calculations based on past delinquencies and fees that the issuer's unable to collect, although the 25% cap of the delinquent payment amount still stays in place here.

And there was a clarification by the CFPB that in looking at costs, the CFPB emphasized that costs could not include any costs of post charge-off collections because once the account gets to charge off, the consumer is sort of home free. And those costs don't count regardless of what an individual issuer's collection practice might be or the amount of late fees that it might have collected after charge-off.

Now, the CFPB also asked for comments on whether it should go even further. And there's some real question here as to whether in going further, it's actually going outside of its statutory authority. But the CFPB specifically asked whether in addition to this change in the amount of the late fee, they should require a \$15 grace period, and they should tie the ability to take advantage of the safe harbor to a requirement that the issuer offer automatic payment options so that payments could be made as easily and simply as possible using the maximum amount of time that might exist between receipt of the statement and the payment due date. And, of course, they also asked if they should make similar charges to other penalty fees.

There's been a lot of criticism of this proposal, not surprisingly. Even before the proposed rule is out the door, the financial institution trade associations called attention to the fact that the CFPB had made no effort to comply with the Small Business Regulatory and Enforcement Fairness Act or SBREFA.

That act requires a small business review panel whenever a proposed rule will have a significant economic impact on a substantial number of small entities. And the trades stated, I think, quite clearly and emphatically that there was going to be a significant economic impact on a substantial number of community banks and credit unions with assets of under \$850 million.

Obviously, that didn't slow down the CFPB in the least. And so we have comment letters including one from Auriemma that Ballard Spahr helped draft, which emphasized just the amazing deficiencies in this rule, its violation of the Federal Administrative Procedures Act, its arbitrary and capricious nature, both because of the data that the CFPB relied on didn't cover the entire marketplace and because a lot of the data that the CFPB relied on isn't even publicly available, the fact that the CFPB exceeded its statutory authority under the Truth in Lending Act and, if adopted, adopted the rule without observance of the procedures required by law, namely compliance with the Small Business Regulatory Enforcement Fairness Act.

Significant issues under the Truth in Lending Act, the CFPB sort of ignored a number of factors that's required by statute to take into consideration like the costs incurred by the creditor from the failure to make late payments.

The deterrence impact of the late fee recall that the CFPB's report in March reports to find that there is no deterrent effect and the conduct of cardholder. And it seemingly ignores a lot of very significant public policy implications, namely that if the late fee is this low, you're basically encouraging cardholders to miss payments because they're not all that much worse off in a monetary sense, but there are going to be additional negative impacts such as the loss of grace period on purchases, increased risk of higher debt, higher delinquency rates, lower credit scores, lower available credit, et cetera.

A number of comment letters have been submitted, as I mentioned, more than 225. I think the regulations.gov now says 226. One that's particularly noteworthy is the one from the US Small Business Administration, Office of Advocacy, which really calls the CFPB to task for the way it's failed to account for the impact on smaller institutions pointing out that they lack the data to develop a factual basis for certifying that there is no significant economic impact on a substantial number of small financial institutions, that they even lack information to show that small institutions are contributing to the problem, sort of ignoring the fact that the reasonableness test, which requires a fairly sophisticated analysis, just isn't a viable option for smaller institutions, and just ignoring the overall impact that the rule could have on smaller institutions and consumers and small businesses who rely on them should those institutions decide to exit the credit card marketplace. Let me stop there and turn it over to Kristen to talk about deposit fees.

Kristen Larson:

Thanks, John. So next, we're going to talk about some of the deposit fees and the guidance that we've seen there. It first started in 2022 when the CFPB went out and posted bank's NSF fee practices. And this gets back to the kind of the name and shame practice to try to get banks to change their practices.

However, even before this, several banks had already been changing their overdraft and NSF fee practices and reduce their reliance on that type of fee revenue, but yet the CFPB continues to kind of take credit for some of the changes. And then because you didn't really know what to do, they also had to issue guidance to tell you how to avoid charging what they were calling illegal junk fees on deposit accounts. The first part of their guidance was the circular that they issued surprise overdraft fees.

And what these fees are is these are fees where, at the time the transaction is authorized, the account balance is positive. But when the transaction settles, the account balance is negative and results in a fee. And so those are fees that the regulators do not like, and they publish the circular on it.

The second one kind of came out as well for unfair returned deposited item fee. So this is John writes me a check, I deposit it, that check bounces, and is returned unpaid. And then I'm assessed a fee for that. And they say, "That's an unfair practice because the person depositing the check doesn't know that the item will not be returned unpaid."

They also had the special edition on junk fees of their supervisory highlights. And there, the examiners had UDAAPs that they found when financial institutions were assessing fees for again the authorized positive, settle negative, the multiple NSF fees on the same transaction.

And so what this is, is this is when a merchant or a pay presents an item for payment, think a like check or ACH debit, and it's returned unpaid. And then they have the right to represent that item for payment the second and maybe sometimes up to a third time. And each time, they're returned unpaid what a lot of the practices is to charge fees in those instances by the banks. And so that's something again that they don't like that practice because they say the consumer is in no position to know that the merchant or pay is going to keep representing the same item.

And the next thing was return deposited items, which I mentioned above from the prior compliance bulletin. And they've also did some reports that suggest there's a decline in the banks' overdraft and NSF fee revenue. And again, that comes from some of the proactive changes that the banks were making on their own and that were well in process prior to the CFPB issuing some of this guidance.

Essentially, what their data found is that it was 43% lower in the third quarter of '22 than it was in the third quarter of 2019, which resulted in 5.1 billion less fees. And the CFPB has also highlighted the overdraft and NSF fees in their fall '22 rulemaking agenda.

And then, recently, the end of last month, the OCC issued a bulletin again on authorized positive, settle negative over a fee practices and NSF fee practices. Essentially, what this bulletin focused on is that even if your disclosures are good and you completely and totally explain and disclose when the fees will be charged, that they still think the practice could meet the definition of unfairness under UDAAP.

And they said kind of the same thing related for the multiple NSF fees. When the disclosures are correctly explaining and disclosing to consumers that we charge this fee each time an item is presented, that that may not be good enough because the consumers still have no control over when a return check or ACH transaction may be represented and lacked the knowledge of whether an intervening deposit will be sufficient to cover the transaction and related fees.

Now, the OCC also lists some additional practices that can create the heightened UDAAP risk, and this is under Section 5 of the FTC Act, and that's where you have either no limit or a high limit on the number of overdraft and NSF fees that are charged per day. And they also do not like the practice of charging a fee to the account for sustained overdrafts on the account.

The FDIC also has issued guidance on overdraft and NSF fees. At the same time, they actually came out with their guidance on the charging overdraft fees for authorized positive, settle negative, although for those regulated by the FDIC, this really isn't new guidance from them because they had prior guidance in 2018 and 2019 as well. Again, similar to the prior guidance, they're highlighting the risk of charging authorized positive, settle negative overdraft fees, and that it can result both in the UDAAP or UDAAP violations because the consumers are unable to recently avoid the injury.

We don't exactly agree with this. But again, this is the guidance that's coming out, and they're encouraging institutions to review their disclosures and account agreements to ensure that the fees are communicated accurately and clearly. But again, they have a similar comment that's saying good disclosures don't fully address either the Dodd-Frank UDAAP or the FTC UDAAP risks associated with authorized positive, settle negative transactions and related overdraft fees.

And they also had prior guidance in 22 August of that year related to the multiple representment NSF fees. And they're recommending at that time that you eliminate your NSF fees or you not charge more than one NSF fee for the same transaction. And, obviously, you know that the latter part of that is very difficult because it's hard to program your system to know whether it's just a similar charge for a transaction or whether it's truly a represented item because there's nothing when the item gets resent where they're telling you, "Yeah, we're resending... or representing this item."

They also suggested that you self-identify representment NSF issues and take full corrective action, and that if you did that, they're going to recognize your proactive efforts to self-identify and correct violations. There's also been some guidance in the state. There's been guidance as stated here out in New York, the Department of Financial Services, and issued a industry letter related to the authorized positive, settle negative fees, double fees that could occur from overdraft protection transfers that didn't actually cover the full overdraft and, again, NSF fees for multiple representments.

New York also enacted a bill to require the department to study overdrafts. Again, we haven't seen that study come out yet. And then in the most recent fiscal budget for '24, the government proposal targeted overdraft and NSF fees and contemplated legislation that would expand the Department of Financial Services guidance. Massachusetts also issued a supervisory alert of March 21 related to multiple representment NSF fees.

And that takes us into the next topic that we wanted to cover, which is CFPB's supervisory and enforcement activity. I wanted to talk a little bit about some of the deposit consent orders that we've seen. Unlike the CFPB, I don't do the blame and shame game. So I'm just going to cover them at a high level if you want to review them in greater detail. You can go to the CFPB's website to look at the specific orders.

But the first one related to unfairly freezing consumer accounts where there was suspected frauds when there were lesser restraints that were available, making deceptive claims on the availability of waivers of monthly service fees and unfairly charging overdraft fees for authorized positive, settle negative.

We had another one for charging overdraft fees for authorized positive, settle negative, one for opening accounts without a consumer knowledge. They also issued a new circular, which I wanted to highlight here. This isn't a part of the consent orders, but it made sense to edit in here that focused on reopening closed accounts. And so that's something to pay particular attention to.

They do not like the practice of reopening closed accounts when a new debit or credit comes in after the account has been closed. Another consent order was for processing illegal out-of-state garnishment orders against the customer's bank accounts. So that makes sense to look at some of your garnishment practices and make sure that you're following the state laws for how those accounts should be garnished.

Another one was in the prepaid card space, and it was denying notices of errors, freezing accounts based on a flawed fraud filter, impeding benefit efforts for errors and getting money back, failing to conduct reasonable investigations. I mean, this is a trend that we've seen across a variety of products as well.

Alan Kaplinsky:

Okay. Well thank you, John, and thank you, Kristen, very much for providing a very thorough and up-to-date description of what is happening with credit card late fees and deposit account fees. And we're going to next week be releasing part two of our program. And part two will involve both John and Kristen will be back, but we will be joined by Mike Gordon.

And in this segment, we'll be talking about the CFPB supervisory and enforcement activity related to what it considers to be junk fees in connection with various activities engaged in by banks and non-banks, in particular taking deposits and auto servicing.

Kristen will cover mortgage servicing junk fees. Next week, John will cover payday and small dollar lending, student loan servicing, and debt collection. Mike will have some observations to make regarding potential developments of the CFPB, and I will attempt to provide a framework that we have been using at Ballard Spahr when we are asked by clients how should they react to all these junk fee initiatives.

And as you've heard by listening to this webinar, and as you'll hear next week, what the CFPB has done and what the other regulators has done is not terribly helpful because they have not created a framework for analyzing whether a particular fee is, I'm not going to even call it a junk fee, is unlawful because that's really the key issue, not what label you put on the fee, what pejorative label junk fee.

But I want to know, and my clients want to know, is it lawful, and can we disclose it in the manner which we would like to disclose it? And I promise you next week, you'll hear all about that framework. 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.