Proposed Rule – Overdraft Lending: Very Large Financial Institutions

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Submitted by mlongacre on Mon, 04/01/2024 - 15:03

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Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20552
Comment Intake – 2024 NPRM Overdraft
c/o Legal Division Docket Manager
Docket No. CFPB-2024-0002
RIN 3170-AA42

Re: *Proposed Rule – Overdraft Lending: Very Large Financial Institutions*

Dear Sir or Madam:

The Conference of State Bank Supervisors[1] ("CSBS") provides the following comments on the proposed rule titled *Overdraft Lending: Very Large Financial Institutions*[2] ("proposal") issued by the Consumer Financial Protection Bureau ("CFPB"). The proposal would apply to all insured depository institutions with more than $10 billion in total assets ("covered institutions"). The proposal would amend Regulations Z and E to deem "above breakeven overdraft credit" provided by covered institutions to be extensions of credit subject to numerous disclosures and protections under the Truth in Lending Act ("TILA") and Regulation Z. Overdraft services provided by covered institutions at or below their so-called "breakeven point" or at a CFPB-established benchmark fee would be considered a "courtesy" service and would not be subject to Regulation Z. Overdraft services provided by institutions with less than $10 billion in total assets, regardless of its pricing, would not be subject to Regulation Z.

The CFPB should withdraw the proposal and issue an advanced notice of proposed rulemaking ("ANPR") in its place. The proposal would significantly alter the regulatory treatment of overdraft services, with potentially far-reaching consequences for the 23 million households that pay overdraft fees annually[3] and the estimated 93% of banks that offer an overdraft program.[4] In effect, the CFPB would, by regulation, set the amount of fees that banks could charge consumers when they overdraw their accounts because the alternatives, as discussed below, would be impractical and/or pose significant operational costs and compliance risks.

State regulators support strong consumer protections, including protections related to overdraft services.[5] However, the proposal raises significant questions, issues, and uncertainties that merit public input *prior* to the CFPB issuing a proposed rule, including:

- The CFPB's proposal rests on questionable interpretations of TILA and Regulation Z.
- The proposed alternatives for providing overdraft services do not appear to be equally viable, and all three could lead to decreased options for consumers across a wide range of financial institutions.
- The proposal fails to consider conflicts with state law.

Significant Issues Raised by the Proposal

The CFPB's proposal rests on questionable interpretations of TILA and Regulation Z.

Overdraft Services and TILA's Definition of "Credit"

State regulators do not believe that TILA supports the CFPB's conclusion that overdraft services, as structured by banks, meet the definition of "credit" – *i.e.*, "the *right* granted by a creditor or debtor to defer payment of a debt or to incur a debt and defer its payment."[6] A "right" is defined as a "legal entitlement to obtain something." Simply stated, under bank overdraft programs, a consumer does not have a legal right to have a bank pay the overdraft. Thus, coverage of such programs does not meet the statutory definition of credit. The evidence provided in the proposal to support the CFPB's conclusion appears contradictory. However, many of the proposal's significant revisions hinge on whether overdraft services are "credit" under TILA, specifically the large-scale changes to "non-covered overdraft credit"[7] services that are offered by a financial institution.

When the Federal Reserve Board ("FRB") promulgated Regulation Z in 1969, it provided that overdraft services were *not* an extension of credit and that overdraft fees were *not* finance charges subject to Regulation Z.[8] For over 50 years, this has been the consistent reading of TILA. Consumers do not have a "right" to overdraw their deposit accounts (*i.e.*, incur a debt and defer its payment), and financial institutions have discretion to either cover or decline transactions that would overdraw these accounts.[9] For decades, under FRB rules, such overdraft services have been considered features of transactional deposit accounts, governed by Regulation E[10] and Regulation DD.[11] While most overdraft services are "automatic," account agreements provide that a financial institution retains the discretion to pay or not pay items that overdraw the account.

The CFPB contends that the FRB relied on its *exception* authority to exempt overdraft services from Regulation Z, and that overdraft services meet TILA's definition of credit. Arguing that this exception is non-statutory, the CFPB says it has authority and discretion to end this exemption. The proposal would do so, but only for overdraft services that covered institutions provide at "above breakeven" costs.

The CFPB argues that the original exemption was based on the FRB's desire to allow financial institutions the option to provide consumers with the occasional "courtesy" of honoring checks that inadvertently overdrew their accounts.[12] The CFPB contends that this historic exemption now allows covered institutions to exploit a regulatory loophole that has emerged over time due to technological advances, increased debit card use, and fees that exceed the cost of covering overdraft items. The CFPB states that the existing overdraft disclosure requirements in Regulations E and DD are not sufficient for fulfilling TILA's purpose of promoting the informed use of credit.[13]

However, the FRB did not state that it was using its exception authority to carve out "courtesy" overdraft services when it implemented Regulation Z in 1969,[14] nor do the numerous historical FRB interpretations cited in the proposal state that overdraft services are a non-statutory exemption from TILA.[15] These interpretations simply describe overdrafts as a courtesy that a financial institution may provide when consumers inadvertently overdraw their accounts.[16] They do not outline or mandate certain features or parameters that overdraft services must comply with to enjoy an exemption from Regulation Z. As opposed to the FRB relying on its exception authority as presumed by the CFPB, the historical record suggests that the FRB properly applied the definition of "credit" in TILA and determined that overdrafts on deposit accounts did not satisfy the definition.

Proposed Regulatory Treatment of "Breakeven" Fees, "Above Breakeven" Fees, and Fees Charged by Smaller Financial Institutions

Assuming *arguendo* that the CFPB's unprecedented extension of the TILA definition of "credit" to cover overdraft services is somehow lawful, state regulators question whether the CFPB's attempt to create new regulatory distinctions between overdraft fees, based on the fee's amount or the size of the financial institution charging them, is reasonable and supported by a plain reading of TILA and Regulation Z. Specifically, the proposal would establish new non-statutory exceptions under TILA for "finance charges."[17] Overdraft fees that are at or below a covered institution's so-called "breakeven" point would not be considered finance charges for purposes of Regulation Z, while overdraft fees that are "above breakeven" would be considered finance charges. Additionally, any overdraft fee assessed by a financial institution under $10 billion in total assets would not be considered a finance charge, regardless of whether it charges a breakeven or higher fee.

There is no evidence in TILA that the *amount* of a fee determines whether it is a finance charge, nor does it state that fees charged by financial institutions of a *certain size* are finance charges or not. These distinctions appear arbitrary and inconsistent with the express provisions of TILA.

This approach also seems irrational from a consumer protection standpoint and could very well lead to consumer confusion. Consumers would receive dramatically different information based solely on the size of their financial institution or the amount of any overdraft fee, contrary to TILA's statutory goals and purposes of providing *consistent* information to consumers so that they understand the terms and conditions of credit.

For example, under the CFPB's proposed approach, a consumer who opts-in to overdraft would receive vastly different information about this service depending on whether a bank has assets of greater than $10 billion or not. Regulation Z rules would govern one bank, and Regulation DD rules would govern another bank – for the same overdraft service.

Moreover, if Bank A charges the proposed "breakeven" or "benchmark" fee, those overdrafts would not be deemed credit, and thus would not be covered by Regulation Z, even if those consumers have, for example, 10 overdrafts in a month. On the other hand, if Bank B charges an "above breakeven" fee, those overdrafts *would* be deemed credit and *would* be covered by Regulation Z, even if consumers have one overdraft every three months.

The proposed alternatives for providing overdraft services do not appear to be equally viable, and all three could lead to decreased

options for consumers across a wide range of financial institutions.

Three Options for Overdraft Services by Covered Institutions

State regulators question whether the proposal's three options for covered institutions to provide overdraft services are equally viable. Moreover, all three options seem likely to decrease overdraft options for consumers. An ANPR would provide the public with additional opportunity to comment on the merits of the options and their impact on consumers and financial institutions.

According to the proposal, covered institutions would be able to continue providing two types of overdraft services that would remain "exempt" from Regulation Z, provided that the financial institution charges either a "breakeven" fee or a "benchmark" fee set by the CFPB.[18] Under the third option, covered institutions would be able to provide "above breakeven" overdraft services that would become newly subject to Regulation Z and Regulation E, as well as other legal requirements under various federal and state laws.[19]

"Breakeven" Overdraft Option

Covered institutions are highly unlikely to calculate and charge their own "breakeven" costs when the result is simply cost recovery. The proposal would allow financial institutions to recover only a limited set of *direct* costs from administering their overdraft services. Determining which costs are specifically and directly connected to the provision of overdraft services could be extremely challenging. Additionally, covered institutions would need to conduct this breakeven analysis annually to determine the resultant overdraft fee.[20] Ultimately, the heightened regulatory scrutiny surrounding overdraft services, lack of regulatory guidance on calculating and determining which costs qualify as "direct costs," and the amount of data and work needed to calculate an annual breakeven point for overdraft services will discourage covered institutions from choosing this option.

"Above Breakeven" Overdraft Option

Covered institutions are also highly unlikely to provide "above breakeven" overdraft services as these would be considered an extension of credit under Regulation Z. Overdraft fees that exceed a financial institution's "breakeven" cost would be deemed a "finance charge," and the overdraft would now be treated as open-end credit for which financial institutions would need to calculate and disclose an APR. In the likely event that a consumer used a debit card to overdraft the account, the card would be considered a "hybrid debit-credit card" now subject to Regulation Z's CARD Act provisions.[21] Covered institutions providing overdraft services at “above breakeven” costs would quickly trigger a raft of significant new regulatory requirements and restrictions, including but not limited to:

- Establishing a separate overdraft credit account that is distinct from the consumer’s deposit account;
- Providing account opening disclosures;
- Providing periodic statements;
- Assessing the consumer’s ability to repay the overdraft credit;
- Prohibiting the bank from offsetting amounts owed on the overdraft credit account with funds in a deposit account;
- Offering at least one alternative method of repayment besides automatic debits from a deposit account; and
- Complying with interest rate restrictions under state usury limits and the Military Lending Act.

These new open-end credit accounts would carry heightened repayment risk due to their extended credit horizon, especially compared to current overdraft services that are typically repaid within three days when a consumer deposits additional funds into the account. Providing “above breakeven” overdraft services would also trigger capital requirements for covered institutions. The open-end credit accounts would represent new assets for the financial institution, with associated credit risks. Under the current standardized approach, these open-end credit accounts would be subject to a 100% risk-weight for capital purposes.[22]

New compliance costs and requirements, a lengthier repayment period, and new capital requirements would not make “above breakeven” overdraft services a practical option for most covered institutions.

“Benchmark” Overdraft Option

The proposal would allow covered institutions to provide overdraft services at a CFPB-established “benchmark” fee, which would be set at $3, $6, $7, or $14. This to-be-established price cap would effectively serve as a “safe harbor” for overdraft services. Covered institutions relying on the benchmark fee would avoid all the risk and uncertainty associated with calculating one’s own breakeven cost, and they would avoid all the substantial regulatory and operational requirements associated with offering above breakeven overdraft services.

However, it is not clear that the proposed amounts for the benchmark fee reflect the true sum of costs associated with administering overdraft services.[23] The benefit of regulatory certainty under a “safe harbor” fee still may not outweigh the cost of providing the overdraft service. Ultimately, it is unclear whether a covered institution would view this option as more attractive than scaling back or exiting overdraft services altogether.

The proposal does not consider potential impacts to consumers, smaller financial institutions, or the broader deposit market.

Even if overdraft fees are lowered according to the proposal, state regulators are concerned that consumers may not be better off financially. If covered financial institutions broadly retreat from providing overdraft services, consumers may be subject to a wider range of fees from financial institutions and others when their transactions are declined. For example, instead of an overdraft fee, a financial institution may impose an NSF fee for consumers who overdraft via check, and any merchant who was paid with such a check could also impose an NSF fee. Consumers could also face late fees, and more serious financial consequences, if they are unable to meet mortgage, rent, or utility payments via overdraft.

While the proposal would apply to financial institutions with $10 billion or more in total assets, the impact could very well descend to smaller institutions. Due to basic market competition, community banks may adopt the overdraft practices of their larger competitors or simply scale back their provision of overdraft services as well. The CFPB also makes clear that it will consider extending this rule to community banks in the future.[24]

State regulators fear that the proposal could exacerbate the already significant deposit concentrations at the very largest financial institutions.[25] Among the various overdraft options, it seems likely that only the very largest financial institutions would have the scale to distribute the costs associated with offering either “breakeven” or “above breakeven” overdraft services. Other financial institutions, including community banks, are likely to pull back from providing overdraft services to consumers. The proposal could cause a significant number of the 23 million households with overdrafts[26] to migrate their deposits to the largest financial institutions. Based on the CFPB’s views and policy objectives, this seems like a consumer outcome that it would want to seriously avoid.[27]

The proposal fails to consider conflicts with state law.

Consumer protection and financial regulation are matters of “profound local concern.”[28] While there is certainly a shared interest between state and federal authorities in protecting consumers and regulating financial institutions, this shared interest must also be balanced and complementary. Unfortunately, the proposal rejects a balanced and complementary approach by creating needless conflicts with certain state laws that apply to covered institutions and their provision of overdraft services. The CFPB admits as much, noting that its proposal “may affect other legal requirements under various… State laws.” Concerningly, it also admits that it “has not attempted to quantify the effects of such changes because it is not responsible for interpreting those laws and regulations and therefore cannot provide the detailed predictions about their effects that would be required for quantification.”[29]

State regulators note that it is absolutely the responsibility of the CFPB to engage in a thorough rulemaking process that seeks to identify, consider, and avoid, to the extent possible, unnecessary and unwise conflicts with state laws. This is a primary reason for, and benefit of, the ANPR process. Through an ANPR, the CFPB would be able to garner feedback and insight that helps it minimize conflicts with other state legal requirements if and when it issues a proposed rule.

State legislatures and state regulatory agencies have taken varied approaches to regulating overdraft services, considering and balancing consumer protection and need, as well as regulatory parameters and certainty for financial institutions. For example, some states specifically exclude overdraft fees from coverage under state usury limits.[30] The proposal would create conflicts with these state laws by requiring any covered institution providing “above breakeven” overdraft services to consider overdraft fees as “finance charges” under TILA, thus treating an identical fee in a contradictory manner under federal rule and state law. Covered institutions would face the difficult task of managing an existing overdraft program under separate compliance standards, or they may opt to revise (or more likely, scale back) their overdraft services to align with the CFPB’s rule. In effect, the CFPB’s proposal would amount to a *federal* agency unilaterally undermining the will of sovereign *state* legislatures in deciding how their regulated entities provide and consumers receive overdraft services. This is an unacceptable contravention of state authority.

Conclusion

The CFPB should withdraw the proposal and issue an ANPR in its place. An ANPR would provide the CFPB with important feedback on its legal interpretations and authorities under TILA and Regulation Z, potential options for providing overdraft services and their market impacts, and ways to avoid and minimize unnecessary or unwise conflicts with state laws.

Sincerely,

Brandon Milhorn
President and CEO

Endnotes

[1] CSBS is the nationwide organization of state banking and financial regulators from all 50 states, the District of Columbia, and the U.S. territories.

[2] CFPB, Proposed Rule, *Overdraft Lending: Very Large Financial Institutions*, 89 Fed. Reg. 13852 (February 23, 2024).

[3] CFPB, *Fact Sheet: The CFPB's Proposed Rule to Curb Excessive Fees on Overdraft Loans by Very Large Banks and Close a Decades-Old Loophole* (January 17, 2024).

[4] CFPB, *Data Point: Checking Account Overdraft at Financial Institutions Served by Core Processers,* Data Point No. 2021-11 (December 2021).

[5] *See, e.g.,* New York Department of Financial Services, *Consumer Fee Practices in New York: A Report on Overdraft, Non-Sufficient Funds, and Similar Fee Practices of New York-Regulated Depository Institutions, Pursuant to Chapter 380 of the Laws of 2022* (July 14, 2023).

[6] 15 U.S.C. § 1602(f) (emphasis added).

[7] *Supra* note 2, at 13854. ("The financial institution typically pays overdrafts up to certain limits but does not agree in advance to pay the overdrawn transactions, reserving discretion to decline any given overdraft transaction… With certain exceptions provided for by internal policies, the financial institution typically assesses a flat fee for each overdraft transaction the financial institution pays. In addition, some financial institutions charge an additional fee or fees, known as extended or sustained overdraft fees, if the

consumer does not bring the account back to a positive balance within a specified period. To collect repayment of the funds advanced to cover overdraft transactions as well as payment of the fees assessed, the financial institution typically deducts those amounts as a lump sum from the consumer's next incoming deposit(s), usually within three days after the account became overdrawn.").

[8] 34 Fed. Reg. 2002 (February 11, 1969).

[9] Alternatively, overdraft lines of credit *are* subject to Regulation Z since "the payment of [overdrawn] items and the imposition of the charge were previously agreed upon in writing." *See* 12 C.F.R. § 1026.4(c)(3).

[10] 12 C.F.R. § 1005.17.

[11] 12 C.F.R. Part 1030.

[12] *Supra* note 2, at 13852. ("In adopting this exception, the Board did not rely on an interpretation of the statute; rather, the Board used its authority to create regulatory exceptions… This exception was evidently intended to allow banks to continue providing limited overdraft services, as a courtesy to consumers who inadvertently overdrew their account, without the banks complying with Regulation Z.")

[13] *Id.* at 13868. The CFPB does not adequately describe the substantial rights and information consumers have regarding overdraft under the extensive regulatory regimes of Regulations E and DD. Nor does the CFPB explain how covering such transactions under Regulation Z would provide *better* information to consumers to help them determine if overdraft services are the best option for them.

Overdrafts, including fees and other amounts, are subject to significant disclosures. Since 2010, banks have been prohibited from assessing fees on consumers' accounts for paying an automated teller machine (ATM) or one-time debit transaction, unless the consumer affirmatively consents, or opts-in to such payment, after receiving disclosures about the service. Banks must provide detailed disclosures on periodic statements about any overdraft fees assessed on the account, regardless of how the overdraft occurred. Moreover, under Regulation E, a consumer has the right to dispute any unauthorized electronic fund transfer, which would include any electronic overdraft.

[14] *Supra* note 8.

[15] *Supra* note 2, at 13866. The CFPB argues for this non-statutory exemption based on several excerpts from FRB publications regarding overdraft services in “History of the Current § 1026.4(c)(3) Exception.”

[16] The CFPB creates its own interpretation of “courtesy” that does not appear in TILA or Regulation Z. *See Id.* at 13868. (“The CFPB preliminarily finds that, where a financial institution sets its overdraft fees at or below its breakeven point, it provides a courtesy service to consumers who overdraw their accounts. Conversely, where a financial institution sets its overdraft fees above its breakeven point, and profits from those fees, it cannot be said to be providing a courtesy.”).

[17] 15 U.S.C. § 1605(a).

[18] *Id.* at 13853.

[19] *Id.* at 13853-54, 13896. Covered institutions may face new compliance requirements under the fair lending rules of Regulation B (Equal Credit Opportunity Act), the Military Lending Act’s fee and arbitration restrictions, and certain Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act) provisions when extending overdraft credit via a hybrid debit-credit card.

[20] *Id*. at 13870.

[21] 12 C.F.R. § 1026.61.

[22] *See, e.g.,* 12 C.F.R. § 217.32(l)(5).

[23] The proposal does not consider the costs of vendors, compliance testing systems, call centers, and several other expenses as “direct costs” associated with administering overdraft programs.

[24] *Supra* note 2, at 13853. ("The CFPB plans to monitor the market's response to this rule before determining whether to alter the regulatory framework for financial institutions with assets less than or equal to $10 billion.").

[25] As of Q4 2023, four out of the nation's approximately 4,600 banks – JPMorgan Chase, Bank of America, Wells Fargo, and Citi – held nearly 39% of all deposits.

[26] *Supra* note 3.

[27] Prepared Remarks of CFPB Director Rohit Chopra on a Press Call on Junk Fees (October 11, 2023). ("Local banks tend to put a heavy emphasis on customer service, because they make their money through their customer relationships. That's why they'll take the time to help you with any problems that arise. But big banks in our country have mostly abandoned relationship banking and have shifted toward algorithmic or assembly-line banking.").

[28] *Lewis v. BT Investment Managers*, 447 U.S. 27, 38 (1980) ("[B]oth as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern. . . . [S]ound financial institutions and honest financial practices are essential to the health of any State's economy and to the well-being of its people. Thus, it is not surprising that ever since the early days of our Republic, the States have chartered banks and have actively regulated their activities.").

[29] *Supra* note 2, at 13896.

[30] *See, e.g.*, O.C.G.A. § 7-4-18(d) ("Notwithstanding the foregoing, fees and other charges agreed upon by a financial institution and depositor, as defined in Code Section 7-1-4, in a written agreement governing a deposit, share, or other account, including, but not limited to, overdraft and nonsufficient funds, delinquency or default charges, returned payment charges, stop payment charges, or automated teller machine charges, shall not be considered interest."); *see also* IA Code § 537.1301(b)(5) ("Finance charge" does not include an initial charge imposed by a financial institution for returning an item presented against nonsufficient funds or for paying an item that overdraws an account. For the purposes of this subparagraph, "item" includes any form of authorization or order for withdrawal of funds from an account such as a check, automated teller machine card, debit card, automated clearinghouse, or other means."); *see also* Mo. Rev. Stat. §

362.111.1 (“A bank or trust company may impose fees or service charges on deposit accounts; however, such fees or service charges are subject to such conditions or requirements that may be fixed by regulations pursuant to section 361.105 by the director of the division of finance and the state banking and savings and loan board. Notwithstanding any law to the contrary, no such condition or requirement shall be more restrictive than the fees or service charges on deposit accounts or similar accounts permitted any federally chartered depository institution and no contractual fee charged for overdrawing the balance of a deposit account shall be deemed interest.”); *see also* Utah Code Ann. §25-5-4(2)(a)(i)(B) (“’Credit agreement’ does not include the usual and customary agreements related to deposit accounts or overdrafts or other terms associated with deposit accounts or overdrafts.”).

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