America's Credit Unions

Regulatory Comment: Summary and Feedback Request

Fees for Instantaneously Declined Transactions

THE ISSUE:

On January 24, 2024, the Consumer Financial Protection Bureau (CFPB or Bureau) released a notice of proposed rulemaking to prohibit covered financial institutions from charging fees, such as nonsufficient funds (NSF) fees, when consumers initiate payment transactions that are instantaneously declined. Under the rule, charging such fees would constitute an abusive practice under the Consumer Financial Protection Act's prohibition on unfair, deceptive, or abusive acts or practices (UDAAP).

IMPACT TO CREDIT UNIONS:

The charging of NSF fees for instantaneously declined transactions is exceedingly rare, so the impact of this rule for credit unions can be expected to be minimal. Credit unions that currently charge NSF fees subject to the proposal would need to adapt their fee structures and ensure compliance with the new rule, potentially requiring changes in internal policies and systems. More concerning than its substance, the Bureau's proposed rule espouses an expansive interpretation of the Bureau's power under the abusive prong of UDAAP that could create uncertainty for credit unions and have significant implications for a wide variety of products and services. Under the rule, the Bureau determined that a fee charged due to a consumer's lack of understanding of their account balance and the risks, costs, or conditions associated with a transaction would be abusive, even if the consumer's lack of understanding was not reasonable. Such a broad interpretation of the abusive prong by the Bureau could lead to almost any disliked practice being deemed abusive and completely disregards consumer responsibility and awareness.

KEY POINTS:

- NSF fees on instantaneously declined transactions, regardless of transaction method, would be prohibited as an abusive act or practice under the Bureau's prohibition on UDAAP. According to the proposal, these types of fees are relatively uncommon.
- Unlike the CFPB's overdraft proposal, the NSF proposal does not include an asset-based exemption. It would apply to all credit unions and any entity that holds consumer accounts or issues access devices for electronic fund transfers.
- The CFPB has stated that they are taking proactive steps to regulate NSF fees as technological advancements may eventually make instantaneous payments ubiquitous.
- Comments to the proposed rule are due to the CFPB by March 25, 2024.

ACTION NEEDED: Deadlines and contacts

Please use the comment link below to respond to America's Credit Unions' survey. This will help shape the discussion and better address your needs in our comment letters.

- Comments due to America's Credit Unions: March 11, 2024 —**Submit here**
- Comments due to the CFPB by March 25, 2024.
- Questions? Contact James Akin, Senior Regulatory Affairs Counsel, America's Credit Unions
- Agency contact: Pavitra Bacon, Senior Counsel Office of Regulation, 202-435-7700

QUESTIONS TO CONSIDER:

1. On which types of transactions do you currently charge NSF fees?
2. Which types of transactions does your credit union authorize that are capable of being declined instantly or near-instantly?
3. Would the proposed rule impact any NSF fees currently charged by your credit union?

BACKGROUND:

NSF fees are charged by financial institutions when a consumer's transaction amount exceeds their account balance. These fees are most commonly levied on checks and Automated Clearing House (ACH) transactions, which do not process instantly. In contrast, NSF fees are rarely imposed on instant transactions like ATM or point-of-sale (POS) debit transactions. However, some exceptions exist, such as for prepaid accounts or transactions at out-of-network ATMs.

Recent trends show that many banks have ceased charging NSF fees. For those still imposing them, the median fee is around $32. The Bureau has determined that NSF fees disproportionately impact consumers with lower incomes and credit scores, often exacerbating their financial vulnerability. Additionally, a large portion of overdraft and NSF fees are paid by a small percentage of account holders. The Bureau's findings indicate that NSF fees, along with overdraft fees, represent a significant cost to consumers, often surpassing other bank fees like periodic maintenance and ATM fees. The fee amount is usually fixed and unrelated to the transaction's processing cost or amount. The rise of noncash payments (ACH, card transactions, mobile app payments) has led to increased NSF fee occurrences, with consumers shifting away from cash partly due to technological and regulatory changes.

Federal regulation has evolved to protect consumers in the noncash payment market. Notable interventions include the 2009 Opt-In Rule requiring consumer consent for overdraft coverage on ATM and one-time POS debit card transactions. This rule led to a significant difference in fee payments between consumers who opted in and those who did not.

More recently, the Bureau's attack on so-called "junk fees" has taken aim at fees not subject to competitive pricing processes. The CFPB has taken actions to reduce bank fees, issue guidance on fee practices, and propose new rules. Other federal agencies have also addressed practices related to NSF fees, focusing on fairness and consumer protection.

SECTION-BY-SECTION ANALYSIS:

A. Definitions (§1042.2)

Section 1042.2 of the proposal outlines several key definitions:

- **Account (§ 1042.2(a)):** This definition aligns with Regulation E, specifically 12 CFR 1005.2(b). It includes checking, savings, or other consumer asset accounts held by financial institutions for personal, family, or household purposes, as well as prepaid accounts. However, it excludes accounts held under a bona fide trust agreement, occasional or incidental credit balances, profit-sharing and pension accounts under trust agreements, escrow accounts for specific purposes, and accounts for purchasing U.S. savings bonds. This alignment aims to maintain consistency with Regulation E and maximize consumer protection.
- **Covered Financial Institution (§ 1042.2(b)):** This term refers to a "financial institution" as defined in Regulation E, 12 CFR 1005.2(i). It includes banks, savings associations, credit unions, or any entity that holds consumer accounts or issues access devices for electronic fund transfers. Motor vehicle dealers predominantly engaged in vehicle sales and servicing are excluded. This alignment is intended to maintain consistency and ensure a level playing field among financial institutions.
- **Covered Transaction (§ 1042.2(c)):** A "covered transaction" pertains to a consumer's attempt to withdraw, debit, pay, or transfer funds from their account that is instantly or nearly instantly declined by a covered financial institution due to insufficient funds. The key factor is that the transaction is processed in real time without significant delays. Transactions declined hours or days later are not covered, nor are transactions initially authorized but later rejected due to insufficient funds. Checks and ACH transactions are typically not covered under this definition unless they evolve to allow instantaneous or near-instantaneous declines.
- **Nonsufficient Funds Fee or NSF Fee (§ 1042.2(e)):** This term refers to a fee charged by a covered financial institution when a consumer's attempt to withdraw,

debit, pay, or transfer funds from their account is declined due to insufficient funds. The name used by the institution for the fee does not determine its classification as an NSF fee. Unlike overdraft fees, NSF fees are only charged after a declined transaction and can have various labels. The proposal broadly encompasses fees that, if charged, would constitute an abusive practice.

The Consumer Financial Protection Bureau (CFPB) is seeking comments on these proposed definitions, particularly on issues related to clarity, emerging payment networks, and the scope of relevant transactions where abusive practices may occur.

B. Abusive conduct/lack of understanding (§§ 1042.2 and 1042.3)

The proposed rule includes the Bureau's preliminary findings related to abusive conduct and the lack of understanding by consumers in the context of charging Non-Sufficient Funds (NSF) fees for covered transactions.

Preliminary Findings on Abusive Conduct: The CFPB is proposing to categorize charging NSF fees for covered transactions as abusive conduct under Consumer Financial Protection Act (CFPA) section 1031(d)(2)(A). This would be based on the premise that such fees:

1. take unreasonable advantage of
2. consumers' lack of understanding of
3. the material risks, costs, or conditions associated with their deposit accounts.

These three factors are discussed in detail below.

C. Material risks, costs or conditions of the product or service

The term "risks" encompasses various possibilities, including the risk of a transaction being declined and resulting in an NSF fee. Once a consumer initiates a covered transaction, it is certain that the transaction will be instantly declined, and a fee will be charged. The Bureau believes that this certainty of harm, with a 100 percent likelihood, means that a consumer who initiates such a transaction without realizing the guaranteed fee lacks an understanding of the likelihood of harm. This risk is considered material due to its tangible and negative consequences.

The "costs" associated with covered transactions resulting in NSF fees primarily refer to the amount of the fee itself, which is typically around $32 in today's market. The Bureau’s view is that even if these fees were lower, they would still be considered material because they represent a non-trivial cost to the consumer, and no service is provided in return. The personal impact of this cost might be heightened if the consumer's bank account has a low balance or is empty.

The conditions of the consumer's deposit account, such as the amount of funds and whether they are sufficient for a specific transaction at the time of initiation, are relevant factors. These conditions relate to when and how financial institutions impose NSF fees, making them material in the CFPB's interpretation.

D. Lack of understanding on the part of the consumer

The CFPB's 2023 Abusive Policy Statement emphasized that the prohibition in CFPA section 1031(d)(2)(A) is based on a consumer's lack of understanding, *regardless of how that lack of understanding occurred*. The CFPB believes that consumers who would be charged NSF fees for covered transactions typically lack an awareness of their account's significant risks, costs, or conditions at the time they initiate such transactions. They argue that when transactions involve substantial risks or costs, and consumers derive minimal or no benefits from them, it is reasonable to assume that consumers who proceed with these transactions do not fully comprehend the associated risks, costs, or conditions. In such cases, consumers pay a price or take on a risk without receiving any benefits in return.

Under this framework several factors would contribute to consumers' lack of understanding of the material risks, costs, or conditions when initiating covered transactions:

1. **Changes in Deposit Account Usage:** The increased use of debit cards for small transactions has led to more frequent account activity, making it challenging for some consumers to track their available funds. Older consumers, in particular, may not use mobile apps to access their account balances.
2. **Complex Account Features:** The Bureau believes that certain account features and settlement practices, like overdraft coverage, can be complex and counterintuitive. Consumers may not understand when overdraft coverage applies or when recent deposits become fully available.
3. **Lack of Awareness about Overdrafting:** Some consumers may not be aware that they can overdraw their accounts with ATM or debit cards. This lack of awareness is more common among those who did not opt into overdraft coverage.
4. **Rapid Decision-Making:** Transactions at merchant point-of-sale terminals, ATMs, and online purchases often occur rapidly, giving consumers little time to check their account balances. Economically vulnerable consumers may face higher barriers to access account information, making them more susceptible to such transactions.
5. **Peer-to-Peer Transactions:** The speed and convenience of peer-to-peer (P2P) transactions can lead to consumers misremembering their account balances, further contributing to a lack of understanding of the costs, risks, or conditions associated with these transactions.

E. Unreasonable advantage-taking

To determine unreasonable advantage-taking, the CFPB evaluates various factors, and it does not require the advantage-taking to be typical or involve a large advantage. Even a relatively small advantage can be deemed abusive if it is unreasonable.

1. **No Service Provided:** NSF fees do not represent fees for any service rendered to consumers. Charging such fees imposes a cost (typically around $32) on consumers without providing any benefit in return. The cost to the covered financial institution for declining these transactions is minimal, making it appear unreasonable for them to impose such fees.

2. **Windfall Profit:** Covered financial institutions have no reason to impose these fees other than to gain profits. They can simply decline the transaction instantaneously, incurring negligible costs. Consumer litigation has highlighted this issue, with some courts considering it unconscionable for banks to charge such fees.
3. **Benefit from Negative Consumer Outcomes:** Charging NSF fees on covered transactions results in the financial institution benefiting from negative outcomes stemming from consumers' lack of understanding. The CFPB considers it unreasonable for financial institutions to profit from, or be indifferent to, negative consumer outcomes due to their lack of understanding.
4. **Vulnerable Consumers:** Many of the consumers who would incur NSF fees are economically vulnerable and may struggle to meet their regular expenses. As a result, NSF fees function as a penalty, imposed on those who do not have enough money in their accounts due to various reasons. The harm inflicted on economically vulnerable consumers from such fees would likely be more significant, making it unreasonable for financial institutions to profit from their hardship.

PROPOSED EFFECTIVE DATE

The CFPB is proposing that this rule have an effective date of 30 days after publication of a final rule in the Federal Register. The CFPB’s proposed expedited effective date is due to the Bureau’s view that the prohibited practice is not thought to be prevalent today, and therefore any burdens associated with implementation of this proposal, if finalized, should be minimal.