Payments Pros: An In-Depth Analysis of the CFPB's Proposed Overdraft Rule
Hosts: Josh McBeain and Chris Willis
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Josh McBeain:

This is a special crossover episode of *Payments Pros* with *The Consumer Finance Podcast*. Today, I'm joined by Chris Willis to discuss the CFPB's proposed overdraft rule. We hope you enjoy.

Chris Willis:

Welcome to this special crossover edition between *The Consumer Finance Podcast* and the *Payments Pros* podcast. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. I'm joined today by my colleague, Josh McBeain, who's one of the co-hosts of *Payments Pros*. We're going to be talking about the CFPB's proposed overdraft rule.

But before Josh and I jump into that, let me remind you to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. Don't forget about our other podcasts. In addition to *Payments Pros* and *The Consumer Finance Podcast*, we have the *FCRA Focus* all about credit reporting. We have *The Crypto Exchange* about everything crypto, and *Unauthorized Access*, which is our privacy and data security podcast. All of those are available on all the popular podcast platforms.

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Now, as I said, I'm joined today by Josh McBeain, who's one of the hosts of the Payments Pros podcast. Josh and I are going to talk about the CFPB's recently published proposed rule relating to overdraft fees. Josh, first of all, welcome to the podcast. I'm glad to be doing this with you.

Josh McBeain:

Thanks, Chris. I'm excited to be here as well.

Chris Willis:

Why don't we just start with the basics? What has the CFPB proposed here in terms of an overdraft rule?

Josh McBeain:

Yes. Basically, in sum, in January, the CFPB published a notice of proposed rulemaking to amend Regulations E and Regulations Z to update sections of those regulations for how they regulate overdraft services. The CFPB is doing this to reign in what they describe as junk fees. They published a report in December 2023 about overdraft fees and NSF fees. They noted that actually in that report that there's been a decline in these fees, but their work with respect to these fees has not been done. That was December 2023. January 2024, now we've got a proposed rule. So they foreshadowed this for us last year.

Chris Willis:

I feel like, Josh, picking up on your last point, it puzzled me that the CFPB felt like it needed to do a rulemaking here because the CFPB has been hard at work trying to drive overdraft fees out of the market since the fall of 2022. The Bureau calls them junk fees at every opportunity. It's done a couple of enforcement actions. It's released a circular. It's done all kinds of public discussion about this. The Bureau has basically declared the fees unfair and abusive, so why the rule?

Josh McBeain:

Yes. It's interesting you mention that. They've been interested in driving them out of the market. They issue this proposed rule to do that. But the proposed rule, it only targets large financial institutions. I mentioned that it makes changes to Reg Z and Reg E, but it only applies to financial institutions with 10 billion in assets or more. For any institution less than that, these changes don't apply. They would be able to continue to charge fees for these services as they currently do today. That's interesting as well.

Chris Willis:

Okay. We know that the proposed rule would only apply to “large financial institutions” over $10 billion in assets. What transactions and accounts are proposed to be covered by the rule?

Josh McBeain:

Yes. Overdraft services provided by covered large institutions. These are services that financial institutions offer in deposit agreements that provide financial institutions with discretion to pay or not pay overdrafts. These overdrafts services are currently regulated by Reg DD and Reg E, and they're exempt from Reg Z. This is basically you're signing up for a deposit account or checking account. You opt in to these services. The large financial institution will may or may not pay overdrafts that you may incur and then charge you a fee for it. Those are the types of transactions we're talking about and the fees associated with those types of transactions.

Chris Willis:

Okay. We know what transactions are covered. What would the proposed rule do to them? I remember it being fairly complicated. It was sort of like you can either do A or B, but tell us what A and B are.

Josh McBeain:

Yes, it is fairly complicated. But in sum, so I think the types of overdrive services we're talking about today are not subject to Reg Z. Reg Z has a long-standing exemption for finance charges. It exempts charges imposed by a financial institution for paying items that overdraw an account from the definition of finance charge. Meaning overdraft fees for the types of overdraft services we are discussing are generally not subject to Regulation Z disclosure requirements. Financial institutions that honor overdrafts do not become a creditor with respect to these discretionary transactions and subject them to Reg Z.

What the proposed rule does is it would alter the definition of finance charge to eliminate this exemption for fees assessed on courtesy overdrive services. The impact of this change is that it would subject the large financial institutions to Regulation Z's disclosure and substantive provisions. This is important to note as well. Overdraft services accessible by a card would be subject to the CARD Act provisions of Reg Z, so the credit card provisions.

Chris Willis:

Okay. We'll talk for a second about how you would make truth and lending disclosures about an overdraft service. But as I recall, the CFPB sort of provided another alternative, an out for financial institutions to provide overdraft services without subjecting to Truth in Lending Act. They're credit sometimes, but sometimes they're not credit. When are they not credit?

Josh McBeain:

Yes. The proposed rule gives large financial institutions two ways to continue charging overdraft fees and avoid the proposed rule's new definition of finance charge and, therefore, avoid Regulation Z disclosures. The first option is to set fees at or below the institution's "break-even point" for overdraft services. This requires the large financial institutions to calculate the fee based on the proposed rule's prescribed requirements and limitations. Chris, as you can imagine, it would also have to be satisfactory to the CFPB.

Chris Willis:

Right. But that calculation, I mean, I don't want to go into the details of it. But my impression of it was that it was prescribed in a very limited way so that the break-even amount would make sure that the financial institution is at best breaking even and not making any money off of the imposition of the fee. Is that basically the point?

Josh McBeain:

That is correct. There's a second option. The second option is to charge a benchmark fee, basically, that the CFPB is going to set as a safe harbor, which will likely be somewhere between $3 and $14 because that's what the CFPB put in the proposed rule. The CFPB is actually requesting comments on this exemption, whether they should have it. If so, what the appropriate fee threshold should be. If you're above this amount, it's a finance charge, and you're subject to credit disclosures. If you're below one of these amounts, you could continue providing these services as you do today. That's how the large financial institutions could potentially avoid this based on the proposed rule.

Chris Willis:

There are also some changes to Reg E that are in the proposed rule. Do you mind highlighting those for the audience?

Josh McBeain:

Yes. This actually goes to how long you have to pay back. Regulation E currently prohibits compulsory use for pre-authorized electronic fund transfers from consumer asset accounts, which is colloquially referred to as sort of prohibiting autopay from a deposit account for a credit product. Regulation Z also currently provides an exemption from this general rule for overdraft services of the type we've been discussing. The CFPB's proposed rule would eliminate this exemption for overdraft plans.

Chris Willis:

Okay. That seems to be a pretty material change, too. We can just sort of leave ourselves to speculate about how someone would operationalize something like that and how it would impact these arrangements. But let's just sort of pick up with next steps. I mean, this is just a proposed rule after all. Just can you take the audience through kind of what are the next steps in terms of the rulemaking and the industry's opportunity to respond to it?

Josh McBeain:

Consumers and financial institutions have until April 1st to voice their comments and concerns with the CFPB. After April 1st, the CFPB will consider those comments and either release a revised proposal, an interim rule, or a final rule. The CFPB states in the proposed rule that the rule will go into effect on October 1st. That is at least six months after the publication of the final rule in the Federal Register. The CFPB expects this rule to be effective October 1st, 2025. If that actually occurred, we would expect to see a final rule sometime before March 2025.

Chris Willis:

Which that's pretty ambitious. I mean, I remember the CFPB talking about the big hurry they were in with the credit card late fee rulemaking. That one took about three months longer than I thought it was going to take based on the we're in a giant hurry to finalize it statements that The

Bureau was making. I don't ever remember the CFPB finalizing a rulemaking in less than a year, but the timeline you just mentioned would suggest they would have to finalize it by April 2025 at the latest.

Josh McBeain:

Correct. I'm interested to get your thoughts on this. I don't think we're going to see a final rule by then, but we're going to talk about that.

Chris Willis:

It would surprise me because, again, that would be a new land speed record for The Agency. They've not done it that quickly before and particularly not for one that's this complicated. I mean, the credit card late fee rulemaking had a lot fewer moving parts, and many of them were eliminated in the final rule, whereas this one is quite complex. So it would surprise me if they were able to do it in a year.

Josh McBeain:

It is. I also think that there's a serious problem with this rule and the Truth in Lending Act. I'm excited to talk to you about this specifically because at the same time that the CFPB was publishing this rule, the Supreme Court was hearing a case about Chevron deference. Just for our listeners, before I go into the TILA issue, Chris, I'd love to give our listeners a little bit of a background of the recent Supreme Court case that may impact Chevron deference and remind listeners what Chevron deference is.

Chris Willis:

Sure, of course. The case is called Loper Bright Enterprises. I mean, it's on the Supreme Court's term this year. It basically is an opportunity for the Supreme Court to revisit what's called Chevron deference. Chevron deference is named after a 1984 decision called *Chevron v. National Resources Defense Council* that essentially announced a doctrine from the Supreme Court at that time that said that where an agency is charged by congress with interpreting and applying a statute, if the statute is ambiguous, then a court will defer to an agency's interpretation of the statute as long as it's sort of consistent with the language of the statute. In other words, where there's ambiguity, the agency gets to make the call, so to speak. The courts will provide deference, which we now call Chevron deference, to that agency interpretation.

The thing about Chevron deference is the Supreme Court doesn't seem to have been much of a fan of Chevron deference in recent years. So they haven't cited it in a long time, and they've decided a lot of statutory interpretation cases without deferring to agency interpretations. People had been thinking for a long time that Chevron was sort of on life support. Now, the Supreme Court granted cert in the Loper Bright case to directly decide the issue about whether they're going to continue to adhere to Chevron or not.

Josh McBeain:

That's directly relevant for this proposed rule because as we've discussed, the CFPB proposed changing Reg Z, which is the implementing regulation for the Truth in Lending Act. But the underlying law, the Truth in Lending Act has not changed. TILA still does not include courtesy or discretionary overdrafts within the definition of credit. The statutory definition of credit is the right granted by a creditor to a debtor to defer payment of debt or to incur a debt and defer its payment. Consumers do not have a right to overdraw their accounts, i.e. the right to incur a debt and defer its payment.

Chris Willis:

Right, because it's discretionary.

Josh McBeain:

Exactly. That has not changed. That's why when TILA was published and it was originally interpreted by the Federal Reserve, Regulation Z included an exception in the definition of finance charge for these fees. That interpretation and that exclusion in current Reg Z is consistent with the Truth in Lending Act. The CFPB's reinterpreted TILA in a way that's contradictory to the underlying statute.

Chris Willis:

Josh, what you're saying, essentially, is that if courts are no longer going to give Chevron deference to agencies, then there's not going to be any deference to this CFPB reimagining of what the definition of credit is. The court will need to hue to the specific language in Truth in Lending, which makes, we think arguably and probably very well arguably, a discretionary overdraft service not meet the definition of credit under Truth in Lending.

If that's the case, then the CFPB isn't free to interpret Truth in Lending through Reg Z and say it's credit when the statute wouldn't make it credit because that would be the agency exceeding its authority. Therefore, it would not be a valid interpretation of the statute. That sounds like a very good argument for the industry to challenge this rule if it becomes finalized to me.

Josh McBeain:

Yes. That's why I was particularly interested to speak with you about this today, and I think we're likely to see litigation related to this proposed rule.

Chris Willis:

Rightly so I think.

Josh McBeain:

Yes.

Chris Willis:

Well, and the thing is, honestly, litigation has become such an expected part of rulemaking now because I think from the industry's perspective, the regulators continue to overreach in ways like what we've just talked about here. The industry, I think, feels like it has no choice but to challenge new regulations as they come out in court. The federal judiciary, particularly with the composition of the Supreme Court today, is in a pretty favorable state for industry to challenge agency rulemakings that arguably go beyond The Agency's authority.

I guess we'll have to stay tuned, first, to see if the CFPB finalizes the rule at all. If so, when and then what it looks like and then what the litigation may look like after that if The Bureau stays to the position that it staked out here of sort of sometimes it's credit and sometimes it's not if you obey my price control, so to speak.

Josh McBeain:

Yes, which is just extremely interesting. The CFPB proposed rule suggests that overdraft fees should be treated like other credit and that overdraft fees are finance charges, unless the fees are low enough or charged by certain institutions. Then the same fee may not be a finance charge, and the services may not be credit. Also, how low is enough is to be determined.

Chris Willis:

Yes, sure. Think about what if we said that with respect to a traditional interest rate. Six percent interest is a finance charge, but three percent interest is not a finance charge because it's a break-even. That doesn't make any sense, and so I think you're right to point out that the CFPB's distinction in this regard may not stand up to a rigorous arbitrary and capricious challenge.

Josh McBeain:

This amount distinction, just to be abundantly clear, is not supported by TILA itself.

Chris Willis:

No, of course not. No, because TILA defines finance charge as the amount that you pay incident to the extension of credit, if I recall correctly.

Josh McBeain:

Yes. There's no other circumstance in TILA or Reg Z where a fee's characterization as a finance charge is determined by the amount of the charge or whom charges it. It's a complete reinterpretation of the Truth in Lending Act.

Chris Willis:

Yes. So it doesn't have this amount-based concept, nor this situational concept of sometimes it is and sometimes it's not. I get your point there. Again, I would argue that there's not even an ambiguity in the statute as it relates to that. So we wouldn't even consider Chevron deference. But even if somebody thought the statute were ambiguous, if Chevron gets a stake driven through its heart by the Supreme Court in Loper Bright, then there won't be any deference to the agency's interpretation anyway.

Okay. Well, this has been really interesting, Josh. It's been great for me to hear about the intricacies of the proposed rule, which really it helped my understanding of it a lot. It also really helped me understand how vulnerable the rule might be to a litigation challenge from the industry if it happens to be finalized along the lines that it was proposed. Josh, thanks for joining me and doing this podcast with me as a special joint edition of our two podcasts. Thanks to our audience for listening into today's episode as well.

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Josh McBeain:

Great. Thank you for that.