Payments Pros – The Payments Law Podcast: The CFPB's Final Credit Card Late Fee Rule: Implications and Industry Response — Crossover with _The Consumer Finance Podcast_
Hosts: Josh McBeain and Chris Willis
Guest: Glen Trudel
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Josh McBeain:

This is a special crossover episode of *Payments Pros* with *The Consumer Finance Podcast*. I am joined by Chris Willis to discuss the CFPB's final credit card late fee rule. We hope you enjoy.

Chris Willis:

Welcome to this special crossover edition of *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, and Josh McBeain, who's one of the co-hosts of *Payments Pros* is joining me today to talk about the CFPB's final credit card late fee rule and the industry's reaction to it, which is breaking news that we really want to talk to you about.

But before we jump into that topic, 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 this podcast and *Payments Pros*, we also have *the FCRA Focus*, all about credit reporting. We have *Unauthorized Access*, which is our privacy and data security podcast. And we have *The Crypto Exchange*, about all things crypto. Those are available on all popular podcast platforms.

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Chris Willis:

Now, as I said, we're going to be talking today about the CFPB's final credit card late fee rule, which just came out at the beginning of March. Joining me, as I said, is Josh McBeain, who's the co-host of Trotman Pepper's *Payments Pros* podcast, and our partner, Glen Trudel, who does a lot of work in the credit card space. So, Glen, Josh. Thanks for being on the podcast today.

Glen Trudel:

Glad to be here, Chris.

Josh McBeain:

Yes, thank you. Glad to be here, Chris.

Chris Willis:

So, Josh, let me start with you. Why don't you just bring the audience up to speed on what's happened. Tell them about the final credit card late fee rule and what it looks like.

Josh McBeain:

Sure. Happy to do so, Chris. So, you can think about the final rule as changes for large issuers, which the CFPB has defined as card issuers that together with their affiliates, have one million or more open credit card accounts and small issuers, and there are changes that impact both.

I'll start with the larger issuers first. So, it's a level set. Under current Reg Z, there's a safe harbor for late fees for $30 for the first payment and $41 for subsequent payments. The CFPB’s final rule lowers the safe harbor provision dollar amount for late fees to $8 for large credit card issuers. It also, which is important, eliminates the higher safe harbor dollar amount for subsequent violations for large credit card issuers. Finally, it ends the current automatic annual inflation adjustment, which currently takes place.

So, for small credit card issuers, in the final rule, the safe harbor threshold amounts increased for inflation to $32 and $43 for each subsequent violation. So, sort of a significant difference there. For large credit card issuers, the safe harbor amount is going down to $8. And for small credit card issuers, it's increasing to $32 and $43, respectively.

Chris Willis:

By the way, I thought it was very interesting, because I think in the prepared statement from the director associated with the release of the final rule, the director made the comment that those automatic inflation adjustments were abusive or something like that. I thought that was an interesting choice of words, particularly given what happened with the small issuers.

Josh McBeain:

Well, one more thought on that, Chris. So, in the final rule, the safe harbor threshold amounts were adjusted for inflation to $32 and $43. Small credit card issuers can charge $32 and $43 in the final rule. But large Issuers may also do so for other penalty fees that are not late fees.

Chris Willis:

Interesting.

Josh McBeain:

For example, exceeding the credit limit or return payment. So, just to highlight your point, the CFPB didn't even apply the lower amount for all penalty fees. They only applied it to late fees for large issuers, and they're allowing even large issuers to charge the increased late fee amounts for other penalty fees.

Chris Willis:

Very interesting. I actually hadn't caught that nuance. So, thanks for pointing it out. Glen, let me turn to you for a second. The final rule came out, I think, directionally in the way that we in the industry expected it to. But there are some important differences between the proposed rule and the final rule. Do you mind highlighting those for the audience?

Glen Trudel:

Yes. I can pick up a few. And to Josh's point, one of the things that was in the proposed rule was the concept that this might be extended to cover all penalty fees, and not just late fees. It was NSF or over-limit. That didn't happen in this rule. So, they've made it a little more specific in that regard.

Another is one of the ideas that they were going to have under the proposed rule was that not only would it be at the $8 safe harbor, but there would be this other rule to the effect that whatever you charge couldn't be more than 25% of the payment that is late. The minimum payment, if you will. That did not make it into the final rule, either. Obviously, a very important thing for the banks, and particularly for people who would have to program that as part of their processing platform.

Also, there was the exclusion of small card issuers. The final rule actually doesn't define the large card issuer at all. It defines small as those who have less than a million open accounts in the preceding calendar year, which is interesting that once you cross that threshold, you are no longer a small card issuer after 60 days. So, it would be somewhat difficult for perhaps an issuer who is marginally or approaching the million-dollar threshold, or maybe it's just over it to avoid being a large card issuer, because they need a clean preceding year of being under a million in order to do that. And if they're already over the line, it would be a long time, a good year or more before they could adopt that standard.

Josh McBeain:

Yes. Glen, I want to add something that that's interesting and small card issuers need to pay attention to this definition. So, if they go over, they have 60 days, as you mentioned, to then comply. But what's interesting is the way that they define open credit card account. It's not only cards or plastic that better out that can obtain extensions of credit. It's any balance that's not been charged off. So, if you have issued less than a million cards, but you have people significantly delinquent in your portfolio that have not been charged off, those count.

Glen Trudel:

Oh, yes. Absolutely. It's not open to buy.

Josh McBeain:

Yes. So, it's going to require a diligent portfolio management on an ongoing basis.

Glen Trudel:

Right. Banks that are sort of on the cusp will have to be making a judgment as to whether the loss of revenue, that could follow, go adopt becoming a larger issuer, is going to militate toward growing their portfolio, if they're getting close. It may be worth it to them, it may not be, ultimately.

Josh McBeain:

It's also interesting, the potential loss of access to credit too, right? Because if someone's got a card that they're keeping in their wallet for an emergency situation, maybe those are going to be closed by issuers now, due to inactivity, because people are going to manage their portfolio size. So, it's interesting what the CFPB has done there, and it might actually deprive people access to credit.

Chris Willis:

I think the point of depriving access to credit is also if you can't recover from those who are delinquent via late fees, then does that cause credit standards to tighten, credit limits to tighten, and affect access to credit that way too? The industry, certainly, has made that argument.

Josh McBeain:

Well, what's interesting about that, Chris, is for large issuers, we've got this reduction to $8. But the CFPB said in the final rule, that the rule does not change the credit card issuer's ability to raise interest rates, reduce credit lines, or take other actions to deter consumers from paying late. So, the CFPB is kind of addressing that head on, that they think that might increase the cost of credit, and they're telling large issuers that they can do that.

Chris Willis:

Yes. And it seems quite odd for the Bureau to say that, after having just released a report complaining about how interest rates charged by large issuers are too high. Because that just came out a few weeks ago, didn't it?

Glen Trudel:

Yes, it did.

Chris Willis:

So, I viewed that statement in the press release as trying to guard against or preview arguments against litigation that might arise concerning the final rule, which of course, it did arise. We'll talk about that in a second. Because it seemed otherwise a fairly odd message and this consonant with what it had said, just in that report a few weeks ago.

Josh McBeain:

Yes. I want to address something. So, for large issuers, I talked about we're currently at $30 and $41. There was a reduction to $8. But what I didn't address and what I'd like to get your guys' thoughts on is, it's not just the $8 threshold. That's the new safe harbor. You can go over $8. But there's some burdens with that. What are your guys' thoughts on the final rule with being able to charge more than $8?

Glen Trudel:

Yes. I mean, I don't think that that – well, that hasn't really changed in the sense that that was always an option. But since virtually no one does it, there's no precedent for it. While there were some provisions under the reg, no one has taken that opportunity to make that analysis given the environment, that's probably smart. I don't see the CFPB cutting everyone to an $8 safe harbor, and then being open about the possibility that, "Oh, well, your costs are higher, so you can charge a higher rate."

It also kind of ignores the fact that pursuant to the underlying truth and lending and so forth, these fees are supposed to be reasonable and proportional for the violation. As the case points out, that's a few elements. It includes taking consideration of deterrence, as deterrence, and one of the arguments is that $8 is going to turn into a convenience fee, not a penalty fee. The conduct of the customer, as well as compensating issuers for all of the costs. One of the arguments is that the folk, what they've done here, is taken the deterrent effect out, they've taken the – they've basically limited only to the cost aspect of it. Even then, not all of the cost.

Chris Willis:

And only the administrative cost, essentially, of dealing with the late payment. Not the cost of delinquency, so to speak.

Glen Trudel:

Right. Certainly, after charge off. I mean, that was an express change that they made. They said it was a clarification that struck me more as whole cloth. But after you charge off, any collection fees don't count.

Josh McBeain:

Yes. There's a bunch of commentary now, which you talked about Glen, that no one really uses that exists today for doing this calculation that no one relies on because we have the safe harbor amounts. But it still applies and added to that, to specifically exclude those costs, like you mentioned.

Glen Trudel:

Right.

Chris Willis:

I'm with you, Glen. I don't think anybody or not many people will avail themselves of the opportunity to “show your math and charge a higher fee than the safe harbor”, because honestly, I think you'd be asking for at least supervisory, if not enforcement trouble by doing that.

Josh McBeain:

I agree.

Chris Willis:

Now, there was one other change in the final rule from the proposed rule that we probably should note. I remember the proposed rule having what I consider to be an especially problematic grace period provision in it. And that vanished from the final rule, I think. Is that right?

Josh McBeain:

That's correct.

Chris Willis:

So, basically, it would have created a federally mandated grace period for not imposing a late fee that I believed, at least, would be very confusing to consumers, and the CFPB fortunately, dropped it out of the final rule.

Glen Trudel:

That's right.

Josh McBeain:

Yes, it was. And that was confusing.

Chris Willis:

So, Glen, you made reference to the case. So, let's talk about the case. Because as promised by industry groups, they had basically said, “Hey, if this rule gets finalized, we're going to challenge it in court." And true to their word, just a few days after the final rule was released, there comes the court challenge. So, do you mind, Josh, just telling the audience a little bit about who filed the challenge, where they filed it, and what's the basis for it?

Josh McBeain:

So, it was a collective of trade groups, including the US Chamber of Commerce, along with the Fort Worth Chamber of Commerce, Longview Chamber of Commerce, and the American Bankers Association, Community Bankers Association, and the Texas Association of Bankers collectively filed a complaint in the US District Court for the Northern District of Texas challenging the final rule.

The trade groups argue that in enacting the final rule, the CFPB violated the appropriations clause exceeding its statutory authority, and offered deficient analysis and reasoning, all in order to achieve a preordained outcome that will ultimately harm those consumers the CFPB is charged with protecting. The trading groups further argue that the final rules effective date violates the Truth in Lending Act. The complaint includes five counts, and I actually think Glen already mentioned some of them, specifically relating to violating TILA, which is a really good point.

So, the Truth in Lending Act has provisions about safe harbors. And it says that safe harbors are penalty fees and are presumed to be reasonable and proportional to the omission or violation to which the fee or charge relates. That's what the Truth in Lending Act states. What's curious here is, and I think this is going to come out in litigation, how can $32 and $43 be reasonable and proportional for small card issuers, and not large credit issuers?

Glen Trudel:

That's an excellent point. I was going to say that was a bright spot, I think, for its clarity, that if these are all supposed to be reasonable and proportional, how can it be that for large issuers, $8 is the number for safe harbor. Whereas for small, you're looking at $32. The difference only is how many opened accounts the issuer happens to have.

Chris Willis:

That sounds like it could be arbitrary, Glen. What do you think? Arbitrary?

Glen Trudel:

Maybe even capricious?

Chris Willis:

Maybe?

Josh McBeain:

Yes. I don't know what makes one million the magic number, and I was reading specifically from the Truth in Lending Act there. So, it's important to note that the CFPB has the ability to implement regulations and safe harbors. But it does seem pretty arbitrary how they've done that in this instance. It's particularly interesting, in light of the fact that they they've applied the higher $32 and $43 amounts for all other penalty fees that that large issuers can still charge.

Chris Willis:

Yes. Like over-limit and return payments.

Josh McBeain:

Yes.

Glen Trudel:

Right. With no analysis about that. This is only about the late fees, right?

Chris Willis:

In addition to just filing a complaint, the trade associations also filed a motion for a preliminary injunction, essentially asking the court, the Northern District of Texas, which is where this is filed, to preliminarily enjoin enforcement of the rule while the court considers the challenges. Since of course, the Northern District of Texas is in the Fifth Circuit, which already has a controlling published opinion that the CFPB cannot engage in rulemaking because of its unconstitutional funding structure. One would expect a preliminary injunction to be granted in reasonably short order following the precedent of the Fifth Circuit's decision in the CFSA case, at least of course, until the Supreme Court decide that case, which might be any time. But we don't know when it'll be. We only know it'll be before the end of June.

So, that was sort of the immediate industry response to the rulemaking. But let's go one step further, and I'd love to ask the two of you this question. Let's assume that down the road, the final rule actually survives. It survives both the CFSA decision and this challenge from the trade associations in the Northern District of Texas. What do you think the industry will do? I mean, the industry, both large and small issuers, in response to the final rule. Again, assuming it goes in as finalized at the beginning of March.

Glen Trudel:

Yes. I mean, Chris, I think there's a number of things that we're going to see and I think they may take a page from what the CFPB said they could do, and start looking at pricing, higher APRs. Boosting fees maybe creating new fees, that maybe gets somewhat – gets the same behavior, but isn't quite a late fee. That may be a possibility. Obviously, higher APR is just another possibility. They might raise minimum payments, typically, for those they see have a greater propensity for late payments. Although, that might be a little direct. But ultimately, raising the minimum payment thresholds and tightening as part of tightening credit, you may see annual fees taken increase, and maybe imposed for accounts that don't have them right now, as a way of recouping some of the revenue that they'd be losing from this.

I could see less profitable accounts that may have shown some propensity being closed. Again, tightening the credit risk and increasing their revenue per account. I could see more selectivity in their credit offerings, in terms of flight to quality at the margin, so to speak. There's going to be a lot of more – maybe less directly. There are a lot of co-branded relationships, and a lot of co-branded agreements out there. There’s drop in revenue, at least in the short term, will affect those relationships, particularly those with a co-brand partner has some sort of revenue share agreement with the bank. That can find its way into reduced rewards programs, less lucrative programs, that sort of thing.

If there's less money to be had, then it stands to reason you have less to give away on rewards, right? So, I think those are just some of the things we're going to see, in addition to the cost that they're going to have to deal with in the Herculean efforts of reprinting disclosures, change in terms of consumers, periodic statement reprogramming of their platforms, training of their employees, all of those sorts of things are all reactions, if you will, things that they'll now have to do, because the rule is in effect.

Josh McBeain:

I agree with everything Glen said. I mean, to sum it up, it's either going to be an increase the cost of credit for all consumers, because it's going to be shared, and that's going to be done through higher APRs, or fees elsewhere, or assuming a loss of access to credit.

Chris Willis:

Yes. Or some combination of the two.

Josh McBeain:

Yes. Or some combination of the two. And there'll be significant implementation costs. I mean, Glen mentioned changes to disclosures. I mean, the CFPB published along with the final rule, a bunch of changes to model forms to address this. So, any card issue that's got rely on the model forms or obviously, has late fees at the current safe harbor amounts, those require system updates and disclosure updates.

Chris Willis:

Well, we're obviously going to be continuing to watch what happens with this rule, particularly now that the litigation is in play. Of course, the members of the audience can check our blog anytime for the latest on it. And of course, watch your podcast feed because this is an important thing that we'll probably be podcasting about it again, when significant events happen.

In the meantime, though, Glen, Josh, I'd like to thank you for doing this podcast with me. Of course, thanks to our listeners for tuning into today's episode as well. Don't forget to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com.

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