Payments Pros – Instant Decline, Instant Relief? Unpacking the CFPB's Proposed Rule on NSF Fees
Host: Keith Barnett and Carlin McCrory

Carlin McCrory:

Welcome to another episode of Payments Pros, a Troutman Pepper podcast focusing on the highly regulated and ever-evolving payment processing industry. This podcast features insights from members of our fintech and payments practice, as well as guest commentary from business leaders and regulatory experts in the payments industry.

Carlin McCrory, one of the hosts of the podcast. Before we jump into today's episode, let me remind you to visit and subscribe to our blog, TroutmanPepperFinancialServices.com. Don't forget to check out our other podcasts on Troutman.com/podcasts. We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services and more. Make sure to subscribe to hear the latest episodes.

Today I'm joined by my co-host, Keith Barnett, to discuss the CFPB's latest proposed rule in its war on junk fees. This recent rule which was proposed on January 24th will have the effect of prohibiting covered financial institutions from charging consumers NSF fees on transactions that are declined instantaneously or near instantaneously.

Keith, I'm looking forward to today's conversation and discussing this unique proposed rule from the CFPB.

Keith Barnett:

Yes. So am I, Carlin. This is – it's really interesting.

Carlin McCrory:

Great. Well, we'll go ahead and dive in. Keith, do you want to just go ahead and give a review of what today's podcast will be about?

Keith Barnett:

Yes, sure. You've already mentioned it, but I just want to add that the comment period for the proposed rule is open as of the date of this recording and will close on March 25th, 2024. The CFPB expects to finalize the rule 30 days after publication in the Federal Register, which is unknown at this time. But the CFPB has acknowledged that it is moving at a fast pace. So do not be surprised if the rule is finalized in the late summer or even the early fall.

The CFPB has said that it is proposing what it calls an expedited effective date because it does not believe that the prohibited practice is prevalent, which is interesting as to why they're even proposing the rule. In any event, the CFPB said that any burdens associated with the implementation of the proposal if finalized would be minimal. The CFPB is nonetheless seeking

comment on whether the proposed effective date should be modified to provide additional time for the actual affected parties.

Carlin McCrory:

What does the proposed rule say exactly?

Keith Barnett:

Well, Carlin, it's a pretty short rule which says in substance two things. First, under the proposed rule, it will be an abusive practice for a covered financial institution to charge NSF fee in connection with what they define as a covered transaction, which we will talk about later. Then secondly, any covered financial institution may not assess an NSF fee in connection with any covered transaction. It pretty much says the same thing. A, it's an abusive act or practice. I'm sorry. It's an abusive act, not an abusive act or practice. It's an abusive act to charge an NSF fee. Then secondly, you can't do it.

Carlin McCrory:

Great. Then maybe back up a little bit and tell the audience what are NSF fees.

Keith Barnett:

Yes, sure. In a consumer financial transaction, it's when a consumer attempts to make a withdrawal, a debit or payment or transfer transaction where the amount exceeds the available funds in their account. Right now, a financial institution may decline the transaction and charge a consumer a fee when that occurs. That's called an NSF fee.

Going further, the proposed rule defines the term insufficient funds to refer to the status of an account that does not have enough money to cover a transaction. The CFPB is actually seeking comment on the definition of insufficient funds. I also want to add that the CFPB is proposing to define non-sufficient funds fee or NSF fee. They're saying that that is a charge that is assessed by a covered financial institution for declining an attempt by a consumer to withdraw debit pay or transfer funds from their account due to insufficient funds.

Here's one of the more interesting parts. The proposed definition would also clarify that the name used by the financial institution for this fee is not determinative on the issue of whether it is considered to be an NSF fee. This is important because it is the CFPB's way of saying that it does not care what the financial institution calls the fee or charge. The prevailing definition will be the CFPB's definition.

It also appears that the CFPB want to make the statement to let them know or to let people know that this is separate from overdraft. In fact, the CFPB has already proposed a separate overdraft rule that will be addressed in another podcast. Unlike overdraft fees, NSF fees are only charged after a declined transaction, whereas overdraft fees, the transaction can go through.

Carlin McCrory:

I mentioned this in the introduction, but can you describe a little bit what is meant by declined instantaneously or near instantaneously?

Keith Barnett:

Yes, sure. That's another important part of the rule, right? The CFPB has said that the rule only applies to transactions that are declined instantaneously or near instantaneously. Currently, according to the CFPB, NSF fees are being charged or have been charged on transactions that the financial institution declines either within seconds after the payment is initiated. NSF fees are charged on transactions that are rejected hours or even days after the initial request a pay is made. For example, a check or an ACH transaction, those declinations do not occur instantaneously. Therefore, the NSF fees from those transactions are not instant.

Here, the proposed rule will apply to NSF fees that are charged, for example, in an ATM or point-of-sale debit transaction, which do occur instantaneously. If there is a delay actually in the charging of fees of these types of transactions, the proposed rule as currently written will not cover the transaction. Simply put, Carlin, a declination occurs instantaneously or near instantaneously when the transaction is processed in real-time, and there's no significant perceptible delay to the consumer when attempting such transaction.

Going a little bit further to that, the CFPB is actually soliciting comment on this proposed definition. There are three things that the CFPB wants to know. One, whether the timing component is sufficiently clear to determine coverage. Second, whether the proposed definition appropriately accounts for emerging payment networks and technology innovations. Third, whether the proposed definition captures the scope of relevant transactions where potential abusive practices are occurring in the market or are at risk of occurring in the future.

Interestingly, as I've said before, the CFPB says that it has conducted research. Based upon its monitoring of the market, they say that covered financial institutions rarely charge NSF fees on covered transactions as proposed, and the CFPB is proposing this rule primarily as a preventative measure.

Carlin McCrory:

The CFPB goes into an at-length discussion about abusive practices. I noted within the rule, within reading the rule, that it appears that there's some discussion about disproportionate cost to the consumer being that financial institutions may charge something like $32 for NSF fees. The CFPB also stated that it thinks that these transactions cost the financial institution about half a penny. Can you go into some discussion about what is an abusive act or practice?

Keith Barnett:

Yes, sure. Carlin, as you pointed out, the CFPB spends a long time in its proposed rule discussing what an abusive practice is under these circumstances. I'm going to try to shorten it, given all of the pages that the CFPB spends. But here, as you pointed out, the CFPB is preliminarily determining that charging an NSF fee in connection with a covered transaction

takes unreasonable advantage of consumers' lack of understanding of the material risks, costs, or conditions associated with their deposit accounts. They're saying that that would be abusive.

Now, keep in mind that the CFPB has made this blanket conclusion without looking at empirical evidence concerning the issue of whether a consumer truly understands whether he or she will be charged a fee if that person attempts a transaction and does not have sufficient funds to pay for the transaction. The transaction can be declined. Now, that is not abusive. It is the charging of the fee, any fee, that the CFPB will deem to be abusive.

Also, another interesting point to your earlier point, Carlin, the CFPB states that it considered whether a disclosure would be sufficient, right? A disclosure would say something like, "Hey, if you don't have sufficient funds in your account, we're going to charge you x amount of dollars." But the CFPB, in order to avoid this, and it's interesting how the CFPB could have model language on some things but not others, they're not going to have model language for this because the CFPB has preliminarily determined that although a disclosure might reduce the incidence of abusive conduct, it would not eliminate it completely. At least according to the CFPB, they're looking for complete elimination.

The CFPB added that a financial institution could present a disclosure when the transaction is attempted and explain that the transaction would be declined and a fee would be charged. But they are skeptical that such a disclosure would be feasible because a financial institution is not often a party operating a point-of-sale terminal, ATM machine, or peer-to-peer application interface. As a result, there would not be that disclosure during an instant transaction. For what it's worth, the CFPB has requested for comment on this particular issue. The CFPB seeks comment on whether the practices identified in the proposal are broad enough to address the potential consumer harms and if the description of the preliminarily identified abusive practice should be revised in any way.

They also request any relevant additional data. They say that would be considered. Like I said, that's interesting because the CFPB here is making assumptions as to whether the amount would be reasonable and just automatically saying whatever amount, it's not reasonable because a consumer will not understand even a well-crafted disclosure.

Carlin McCrory:

Under the proposed rule, what is a covered financial institution?

Keith Barnett:

Sure. I don't want to say the CFPB has made it simple, but they sort of made it simple. Here, a covered financial institution is the same definition as it is in Reg E. In plain English, that means that a covered financial institution is a bank, savings association, credit union, or any other person that directly or indirectly holds an account belonging to a consumer or that issues an access device and agrees with a consumer to provide electronic fund transfer services.

It's not exactly clear if you're a fintech in a bank fintech partnership, whether you indirectly hold an account belonging to a consumer when it is the bank that actually holds the account. The bottom line here is given the breath of the definition, the CFPB wants to capture all participants

in a transaction within this definition. Once again, the CFPB is seeking comments related to that particular definition.

Carlin McCrory:

Next, I want to discuss with you a little bit about what has led to the proposal. We discussed in a prior podcast about the CFPB supervisory highlights in the past, and the bureau discussed within these supervisory highlights that came out towards the end of last year the practice of multiple or representment NSF fees. This occurs when after declining a transaction because of insufficient funds and then assessing an NSF fee for the transaction. The transaction is subsequently represented, and then a second NSF fee is then again assessed. The bureau has stated that this is an unfair practice, and it is not permitted. The FDIC has actually identified violations for this same practice as well. What other thoughts do you have on this, Keith?

Keith Barnett:

Well, no, you're exactly right, Carlin. Actually, you don't need to look past the headline of the CFPB's press release on this proposed rule to see what led to the proposal. The headline actually says, and I'm quoting this, "CFPB proposes rule to stop junk fees on bank accounts." As we know, at least during the Rohit Chopra era, the CFPB has used junk fee as a catchphrase for any fee that it does not like.

Here, over the past few years, the CFPB has been looking at NSF during supervisory examinations and enforcement actions concerning the exact issue that you brought up, right, whether or not it's UDAP. You gave your examples of CFPB enforcement actions, including what you just mentioned when there are multiple NSF fees for the same transaction. They're also looking at a lack of clear disclosures. Also, the CFPB had been looking at NSF as a profit center for the banks.

Also, for what it's worth and as the CFPB acknowledges, most of the large banks have gotten rid of NSF. Or they've made it much harder to charge NSF fees. So it's really not as prevalent as before.

Carlin McCrory:

What will be the effect of this proposed rule moving forward?

Keith Barnett:

Right. It's no surprise here that the CFPB had previously found that individuals with NSF fees in the prior year tend to have lower account balances and tend to be more credit-constrained than other consumers, right? They'll have the lower credit scores, less likely to have credit cards. If they do, much lower credit limits.

Another factor here is that the CFPB pointed out in its proposed rule that an FDIC survey found that among the unbanked households in 2021, 30% or at least almost 30% cited as a main reason for not having the account fees related to anything, including minimum balance requirements. The CFPB actually believes that it can help this category of consumers. The CFPB is touting that this proposal has a direct benefit to consumers who would have, otherwise,

had to pay NSF fees on cover transactions which would lead their accounts to be zero or below zero possibly. Or even have their account closed due to not having sufficient funds in the account.

What the CFPB either pretty much ignores or glosses over is that the banks can still close accounts if they have to constantly decline transactions because the consumers don't have the funds in their accounts. The difference here is the charging of the fee in connection with it. Then the other question is query, whether this will make financial institutions more likely to cut off a consumer more quickly when they have NSF fees or even not on-board consumers who are of lower income and not give them a chance to be banked at all.

The CFPB is really interesting. The other thing they added in their statement, they said that without the ability to assess NSF fees on transactions that consumers undertake without sufficient funds, the financial institutions may opt to allow additional transactions to go through and just charge overdraft fees instead. But the CFPB does not appear to see that as a bad thing, at least the overdraft fees, even though they're proposing an overdraft fee rule. The CFPB said, and I'm quoting, “By allowing accounts to go into overdraft, this implies more consumers will receive the items they were attempting to purchase.”

I don't know. It's just really interesting how on the one hand, the CFPB is proposing to eliminate NSF fees and then propose rules related to overdraft. Then in some ways implicitly tout overdraft as a good thing, while they're trying to make a rule about it at the same time. One last thing that I want to add in response to that question is the CFPB said that the proposed rule would have a direct benefit to consumers somewhere between 16.2 million and 64.6 million dollars in reduced NSF fees.

The CFPB doesn't really have data on that. They are speculating. As a result of that speculation, they're actually seeking comment on the extent to which the NSF fees are currently charged on cover transactions and the extent to which they might be charged on covered transactions in the future.

Carlin McCrory:

That's really interesting, Keith. We'll go ahead and wrap it up. But do you have any closing thoughts or comments?

Keith Barnett:

Yes. It's something that I just alluded to a second ago. The other possible effect of the rule which I believe is most realistic and the CFPB even pointed this out where they said that a prohibition on NSF fees could result in financial institutions being less willing to open depository accounts for those consumers. The CFPB kind of glossed over it in their proposed rulemaking. They said, “Oh, well. This will also cost the financial institutions if they don't open these accounts.”

It’s interesting to me because while the CFPB has acknowledged that the unbanked and underbanked are the ones most likely to incur these fees, they acknowledge that this proposal will lead to a larger number of people being unbanked and underbanked because traditional banks will be less likely to open an account for someone who will have a balance that will hover

near zero on a regular basis. Because this category of consumers will not have established banking relationships, that will lead to them being underbanked. Meaning they won't be able to go out and get their traditional loan or build up the credit file that the CFPB wants them to build up.

This will actually, my getting out the crystal ball, will open up opportunities. Well, likely open up opportunities for fintechs in the payments area, as consumers who fall within this NSF fee realm may look to have bank-like relationships with fintechs that have bank partnerships and also other means by which they can have access to credit through fintechs and innovative payments.

Carlin McCrory:

Keith, thanks so much for joining me today. Thanks to our audience for listening. The CFPB has issued a flurry of rules, and we will certainly keep our audience surprised of the status of these rules. In the meantime, don't forget to visit our blog and subscribe, so you can get the latest updates. Please, also make sure to subscribe to this podcast via Apple Podcast, Google Play, Stitcher, or whatever platform you may use. We look forward to next time.

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