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<u>BY ELECTRONIC SUBMISSION</u>

Rohit Chopra
Director
Consumer Financial Protection Bureau
1700 G Street N.W.
Washington, DC 20552

Request for Comment
Overdraft Lending: Very Large Financial Institutions
Dkt. No. CFPB-2024-0002
89 FR 13852 (February 23, 2024)

Dear Director Chopra:

We, the undersigned attorneys general for seventeen states (collectively, the “State AGs”), write in response to the Consumer Financial Protection Bureau’s (“CFPB” or “the Bureau”) request for comment on its proposed rule amending Regulations E and Z under the Truth in Lending ACT (“TILA”) to treat overdraft credits provided by very large financial institutions as loans subject to consumer protections required of similar credit products, unless the overdraft credit is provided at or below cost (the “Proposed Rule”).[1] The State AGs endorse the Proposed Rule, which closes a decades-old regulatory loophole that has enabled very large financial institutions to extract billions of dollars from consumers through exorbitantly-priced overdraft loans without having to comply with longstanding lending laws requiring disclosure of basic credit terms. The State AGs urge swift publication and implementation of a final rule that sets a benchmark overdraft fee of $3—the lowest benchmark proposed by the Bureau. The State AGs also recommend that the Bureau promptly consider expanding application of the Proposed Rule to small financial institutions, given that these institutions are among the most prolific purveyors of costly overdraft loans.

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1 *Overdraft Lending: Very Large Financial Institutions*, Consumer Financial Protection Bureau (published Jan. 17, 2024) (hereinafter “*Request for Comment*”), *available at* https://files.consumerfinance.gov/f/documents/cfpb_overdraft-credit-very-large-financial-institutions_proposed-rule_2024-01.pdf.

I. There is No Basis for Maintaining the Overdraft Fee Loophole.

The historical root of the regulatory loophole for overdraft fees traces back to the first version of Regulation Z, which the Federal Reserve Board (the "Board") published to implement TILA in 1969.[2] At that time, consumers generally withdrew money from their bank accounts in-person or by writing a check. If a consumer inadvertently overdrew their account when writing a check, banks exercised discretion to pay some of the "bounced" checks as a courtesy to the consumer, without charging the consumer any additional fees beyond the amount of the insufficient funds. Thus, although Congress did not exempt overdraft fees from TILA, the Board used its authority to except from Regulation Z "[a] charge imposed by a bank for paying checks which overdraw or increase an overdraft in a checking account . . . unless the payment of such checks and the imposition of such finance charge were previously agreed upon in writing."[3] A Board official interpretation confirmed this exemption was designed to allow banks to "occasionally, as an accommodation to its customer, honor a check which inadvertently overdraws [an] account" without having to comply with Regulation Z requirements.[4]

Yet, since Regulation Z was first adopted, financial institutions have expanded overdraft credit far beyond this historical "courtesy model" in several ways, rendering the initial rationale behind the exception obsolete. *First*, rather than deciding whether to permit overdraft transactions on an individualized basis as a matter of discretion, banks increasingly relied on automated programs or internal overdraft limits that effectively made pay/no-pay decisions in advance.[5] *Second*, banks extended overdraft credit to debit card transactions which, as debit card transactions became more prevalent than checks, drastically increased the number of transactions that potentially triggered overdraft fees, even as debit card transactions typically involved smaller amounts than checks.[6] *Third*, despite the increased frequency and decreased size of overdraft transactions, and automation of overdraft decisions, banks have continued to increase the size of overdraft fees, to the point where most very large financial institutions now charge $35 per overdraft.[7] This $35 charge far exceeds the cost of banks providing overdraft credit, and often exceeds the amount of the transaction that triggered the overdraft in the first

2 34 FR 2002 (Feb. 11, 1969).

3 *Id.* at 2004.

4 42 FR 22360, 22362 (May 3, 1977).

5 *See* FDIC, *Study of Bank Overdraft Programs*, at II-III (Nov. 2008), *available at* https://www.fdic.gov/bank/analytical/overdraft/FDIC138_Report_Final_v508.pdf (finding that the "number of FDIC-supervised institutions providing automated programs has grown rapidly over the past several years" and that "a significant share of customer transaction accounts operated under automated overdraft programs" at large banks).

6 CFPB analysis of account data from large banks showed that approximately 10% of debit transactions occur by check while over 60% occurred by debit card. CFPB, *Data Point: Checking account overdraft*, at 17 (July 2014), *available at* https://files.consumerfinance.gov/f/201407_cfpb_report_data-point_overdrafts.pdf.

7 CFPB analysis from 2023 found that the median overdraft fee for very large financial institutions was $35 per overdraft. CFPB, *Overdraft and Nonsufficient Fund Fees*, at 3 n.2 (Dec. 2023), *available at* https://files.consumerfinance.gov/f/documents/cfpb_overdraft-nsf-report_2023-12.pdf. In contrast, a 1976 survey of banks in Washington D.C. and New York found a median fee of $5, with some banks charging nothing. *See Consumers Guide to Banking: Staff Report on Commercial Bank Charges in the New York and Washington, D.C. Metropolitan Area*, S. Comm. on Banking, Hous. and Urban Affairs, 94th Cong. 10-11 tbl.3 (1976).

place.[8] For instance, many consumers have reported paying overdraft charges of $30 or more after purchasing a $5 cup of coffee using a debit card.[9]

As a result of these changes, overdraft credit has transformed from an occasional courtesy provided to help consumers avoid bouncing checks, to a frequent and costly charge that generates a significant proportion of the fee revenue that banks make from checking accounts. Indeed, by 2008 overdraft revenue marketwide had reached nearly $24 billion.[10] Although, as discussed further below, overdraft revenue has declined from the peaks reached during the Great Recession, banks have remained highly dependent on overdraft fees, with the Bureau's research indicating that overdraft and non-sufficient funds revenue make up close to two-thirds of fee revenue from checking accounts between 2015 and 2019.[11]

As overdraft fee revenue has increased, so has the deleterious effect of such fees on American consumers and their families. As the CFPB has found, the median overdraft fee is $34, even though the median debit card transaction triggering the fee is $24 and most overdrafts are repaid within three days—representing an annual percentage rate ("APR") of approximately 17,000 percent.[12] Aside from the punishing cost of paying overdraft fees, the fees also create hurdles to maintaining a positive account balance, which contributes to involuntary account closures and driving consumers out of the banking system altogether.[13]

Research has consistently shown that the destructive impacts of overdraft fees are disproportionately borne by low-income consumers and consumers of color. A comprehensive study of overdraft-related fees charged in 2019, the last year before the Covid-19 pandemic, found that the overwhelming majority of those fees were assessed to the most vulnerable consumers with the lowest average account balances.[14] CFPB studies have found that "frequent

8 Center for Responsible Lending, *Overdraft Fees, Banks Must Stop Gouging Customers During the Covid-19 Crisis*, at 1-2 (June 2020), *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-overdraft-covid19-jun2019.pdf.

9 CFPB, *Consumer experiences with overdraft programs*, (2022), *available at* https://www.consumerfinance.gov/data-research/research-reports/data-spotlight-consumer-experiences-with-overdraft-programs/full-report/; CFPB, *Prepared Remarks by Richard Cordray at the CFPB Roundtable on Overdraft Practices*, (Feb. 22, 2012), *available at* https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-by-richard-cordray-at-the-cfpb-roundtable-on-overdraft-practices/; NBC News, *$38 for a cup of coffee? Use debit card wisely*, (March 25, 2009), *available at* https://www.nbcnews.com/id/wbna29879567.

10 Center for Responsible Lending, *Overdraft Explosion: Bank fees for overdrafts increase 35% in two years*, at 4 (October 6, 2009), *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-overdraft-explosion.pdf.

11 CFPB, *CFPB Research Shows Banks' Deep Dependence on Overdraft Fees* (December 1, 2021), *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-research-shows-banks-deep-dependence-on-overdraft-fees/.

12 *Request for Comment*, at 63.

13 *See* Center for Responsible Lending, *Overdraft Fees, Banks Must Stop Gouging Customers During the Covid-19 Crisis*, at 3 (June 2020), *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-overdraft-covid19-jun2019.pdf.

14 *See id*.

overdrafters"—those who incur more than 10 overdraft and non-sufficient funds fees within a year—paid 79% of such fees, a median of $380 in a year, despite collectively comprising just 9% of consumers.[15] The same studies found that such frequent overdrafters tend to have lower income, lower account balances, and lower credit scores.[16] Research also shows that Black households and Latino households are 1.9 and 1.6 times more likely, respectively, to have overdrafted a bank account as compared to white households.[17]

Overdraft revenues declined with the onset of the Covid-19 pandemic, likely due to the effect of stimulus payments and a decreased use of debit cards.[18] Beginning in 2021, as public and regulatory scrutiny of overdraft fees and practices has increased, a number of large banks eliminated or reduced overdraft fees, or modified policies to reduce the frequency of overdraft charges, which has caused a reduction in overdraft revenues compared to pre-pandemic levels.[19] While the voluntary measures recently implemented by some banks are a step in the right direction, the CFPB estimates that overdraft revenues in 2022 still exceeded $9 billion, with an estimated 68 percent of those revenues earned by very large financial institutions.[20] Moreover, absent legal reforms, even the incremental progress made through recent changes in overdraft fees and practices at some banks remains at constant risk of regression in the event industry, economic, or political winds change.

In sum, what started as a narrow exemption to Regulation Z designed to facilitate banks providing an occasional accommodation to consumers at a modest fee has morphed into a broad loophole that enables banks to harvest billions of dollars in hefty fees annually from vulnerable populations of consumers. The State AGs agree with the Bureau that it is past time to take action to close that loophole and protect consumers from the damaging impact of these hidden overdraft loans.

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15 CFPB, *Data Point: Frequent Overdrafters*, at 5 (Aug. 2017), *available at* https://files.consumerfinance.gov/f/documents/201708_cfpb_data-point_frequent-overdrafters.pdf; CFPB, *Data Point: Checking account overdraft*, at 12 (July 2014), https://files.consumerfinance.gov/f/201407_cfpb_report_data-point_overdrafts.pdf.

16 *See* CFPB, *Data Point: Frequent Overdrafters*, at 5, 16 (Aug. 2017), *available at* https://files.consumerfinance.gov/f/documents/201708_cfpb_data-point_frequent-overdrafters.pdf.

17 Fin. Health Network, *Overdraft Trends Amid Historic Policy Shifts*, (June 1, 2023), *available at* https://finhealthnetwork.org/research/overdraft-trends-amid-historic-policy-shifts/.

18 *See* CFPB, *Data Point: Overdraft/NSF Fee Reliance Since 2015 – Evidence from Bank Call Reports*, at 7 (Dec. 2021), *available at* https://files.consumerfinance.gov/f/documents/cfpb_overdraft-call_report_2021-12.pdf ("In 2020 during the COVID-19 pandemic, overdraft/NSF fee revenues declined significantly to $8.84 billion, a 26.2 percent decline compared to their volume in 2019").

19 *See* CFPB, *Data Spotlight: Overdraft/NSF revenue down nearly 50% versus pre-pandemic levels* (May 24, 2023), *available at* https://www.consumerfinance.gov/data-research/research-reports/data-spotlight-overdraft-nsf-revenue-in-q4-2022-down-nearly-50-versus-pre-pandemic-levels/full-report/ (noting "[t]he sustained reductions we find in 2022 versus 2019 are likely due to changes in bank policies that started to go into effect toward the end of 2021 and throughout 2022.").

20 *See Request for Comment*, at 17-18.

II. The Proposed Rule Closes the Overdraft Fee Loophole and Helps Protect Consumers from Costly and Pernicious Overdraft Loans.

The Proposed Rule would close the longstanding loophole that has allowed very large banks to extend overdraft credit to consumers without telling them the APR or providing lending disclosures required by Regulation Z. By treating overdraft credit extended for-profit by very large institution like credit cards and other lending products, the Proposed Rule will enable consumers to compare cost across lending products and shop for the most financially attractive form of credit. This enhanced ability to shop across credit products could create competitive pressure that drives down prices, both for overdraft credit and other credit products. To the extent consumers choose to accept overdraft credit to satisfy their liquidity needs, the disclosures required by the Proposed Rule will help them understand that they are entering into a contract for a lending product with a creditor—a reality that is presently obscured by the broad loophole in Regulation Z.

By recognizing that overdraft charges constitute loans and subjecting them to the lending disclosure rules applicable to other forms of credit, the Proposed Rule will also benefit the State AGs' enforcement of their own consumer protection laws, especially in jurisdictions where any commercial practice that violates federal law is also deemed a violation of the State's consumer protection laws. This is true for states like New York, where, in state enforcement actions, any commercial practice that violates federal law is conclusively presumed to be an unlawful practice of the State's consumer protection laws.[21] The proposed rule, coupled with existing state consumer protection statutes, will encourage federal and state governments to collaborate to prevent and abate unfair, deceptive, or abusive practices in the overdraft market.

The State AGs further support the provisions of the Proposed Rule that permit very large financial institutions to charge a modest overdraft fee to recover the financial institution's costs without complying with Regulation Z. Narrowing the exemption in this way accords with its initial conception as facilitating a courtesy service to consumers who overdraw their accounts. And maintaining this limited exemption helps to encourage the availability of overdraft coverage provided as a true accommodation for consumers—which many consumers may find convenient—while still protecting them from hidden and more costly for-profit overdraft lending.

III. The Bureau Should Set the Lowest Benchmark Fee Outlined in the Proposed Rule.

The Proposed Rule states that, for purposes of determining whether overdraft charges are offered at or below cost and thus remain exempt from Regulation Z, the Bureau is considering having financial institutions (1) calculate their own average costs for providing overdraft credit using a standard provided by the Bureau; or (2) charge a benchmark fee at \$3, \$6, \$7, or \$14.[22] The Bureau proposed the range of benchmark fees based on data produced in response to supervisory information requests from five very large financial institutions.[23] The \$3 and \$6 benchmarks represent calculations of the average losses per overdraft transaction across all five

21 *See* N.Y. Exec. Law. § 63(12).

22 *Request for Comment*, at 7.

23 *Id.* at 71-72.

of these financial institutions, while the $7 and $14 benchmarks represent the average losses per overdraft transaction for the one financial institution with the highest losses for its overdraft program.[24] The differences between the $3 and $6 benchmarks, and the $7 and $14 benchmarks, are due to the inclusion of all overdraft transactions when calculating per-transaction losses (for the $3 and $7 benchmarks) or only transactions that resulted in an overdraft fee (for the $6 and $14 benchmarks).[25] Omitting overdraft transactions that did not result in an overdraft fee makes a significant difference in calculating the proposed benchmark because currently a substantial portion of overdraft fees are waived by financial institutions, either per an automatic policy or as a matter of discretion.[26]

The State AGs support setting the benchmark fee at the lowest level proposed by the Bureau: $3. Setting benchmarks of $7 or $14 based on data from the single institution with the highest overdraft losses would enable the other four financial institutions with per-transaction losses below the benchmark (and any other financial institutions subject to the Proposed Rule with losses below the benchmark) to turn a profit from charging overdraft fees that remain exempt from Regulation Z. That result would undermine the Bureau's statutory mandate to promote fair, transparent, and competitive markets by effectively subsidizing financial institutions with lower per-transaction overdraft costs at the expense of consumers. It would also undermine the Proposed Rule's purpose to preserve the Regulation Z exemption only for overdraft credit that is provided at or below cost as a true courtesy to consumers.

Additionally, using a benchmark of $6 (based on the per-transaction losses across all five financial institutions, but only including transactions generating an overdraft fee) would likely undercount the volume of transactions generating a fee post-enactment of the Proposed Rule and thus overstate financial institutions' overdraft costs. This is because financial institutions that charge a benchmark fee would likely grant fewer overdraft fee waivers to compensate for the decreased fees received from each overdraft charge. Moreover, to the extent financial institutions have per-transaction losses above the $3 benchmark fee, adopting such a benchmark would not disincentivize the institutions from extending overdraft credit as a courtesy to consumers, because they could still elect to provide overdraft credit at or below their own costs, as calculated based on the standard set forth in the Proposed Rule.

IV. The Bureau Should Promptly Consider Expanding Application of the Proposed Rule to Small Financial Institutions.

The Bureau limited the Proposed Rule to "very large financial institutions"—*i.e.*, those with more than $10 billion in assets— "[i]n light of the different circumstances smaller financial institutions may face in adapting to the proposed regulatory framework."[27] The State AGs appreciate that very large financial institutions account for most overdraft fees in the aggregate and that unnecessary economic burdens should not be imposed on small banks and other businesses. However, the State AGs urge the Bureau to promptly consider expanding application

24 *Id.* at 72-74.

25 *Id.*

26 *See id.* at 146.

27 *Id.* at 33.

of the Proposed Rule to cover small financial institutions because data indicates that those institutions are among the worst offenders in sticking consumers with costly overdraft charges.

Recent CFPB data shows that 92.9% of small banks and 60.9% of credit unions have an overdraft program, and earned $40.37 and $42.33 in annual overdraft revenue per account, respectively—roughly the same amounts earned per account by large banks.[28] Additionally, smaller financial institutions more often rely on overdraft fees as a profit center, which further supports treating those fees like other for-profit credit products. Indeed, a pre-pandemic report found that six small banks rely on overdraft revenues for more than half of their profit, with three of those banks entirely reliant on overdraft revenues for profits.[29] In 2019 Woodforest National Bank, for example, had overdraft revenues larger than its total profits (meaning the rest of its business lost money), with $135 in overdraft revenue collected per customer account.[30] In contrast, overdraft revenue at JP Morgan Chase—which collected the most overdraft fees in the aggregate that year—amounted to 7% of its total profit and about $35 per account.[31] The State AGs are concerned that these small banks may be extracting more overdraft fees from customers by purposefully targeting customer bases in low-income communities that are more likely to overdraft.[32]

While some small financial institutions may complain that application of the Proposed Rule would reduce their revenues and profits, we do not believe that protecting the earnings and profits of financial institutions, whether large or small, should come at the expense of consumers. When revenue and profits rely on consumers' inability to make informed choices, they are ill gotten. Small financial institutions may also claim that competitive pressure from large banks will eventually cause them to voluntarily adjust their overdraft fees and practices, but comparison shopping between overdraft credit offered by large and small banks will be more difficult for consumers if only large banks are required to make lending disclosures under Regulation Z.

In any case, recent data contradicts the notion that small financial institutions will inevitably follow the lead of large ones in reducing overdraft charges. One recent study found that, as of September 30, 2022, very large financial institutions had reported a decline in overdraft fee income every quarter since the fourth quarter of 2021, while as of the same date smaller financial institutions had reported an *increase* in total overdraft-related service charges in

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28 CFPB, *Data Point: Checking Account Overdraft at Financial Institutions Served by Core Processors*, at 3-4, 6. (December 2021), *available at* https://files.consumerfinance.gov/f/documents/cfpb_overdraft-core-processors_report_2021-12.pdf. In comparison the CFPB found that the overdraft revenue per account at large banks after the application of manual waivers was $41.47. *Id.* at 6.

29 Brookings, *A few small banks have become overdraft giants*, (Mar. 1, 2021), *available at* https://www.brookings.edu/articles/a-few-small-banks-have-become-overdraft-giants/.

30 Politico, *Overdraft Fees are Big Money for Small Banks*, (June 24, 2021), *available at* https://www.politico.com/news/agenda/2021/06/24/bank-overdrafts-big-business-small-banks-495688.

31 *Id.*

32 *See id.* (noting that Woodforest National Bank "locates most of its branches at discount stores like Walmart.").

all of the past seven quarters except for one.[33] Absent regulatory action it is unlikely that smaller financial institutions will meaningfully reform their overdraft programs particularly since, as discussed above, many smaller institutions generate an outsized proportion of their profits from overdraft charges.

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For all the above reasons, the State AGs endorse the Bureau's Proposed Rule and applaud the Bureau's effort to bring increased transparency and competition to the overdraft market. The State AGs urge swift publication and implementation of a final rule that sets the benchmark overdraft fee at $3, and request that the Bureau promptly consider expanding application of that rule to small financial institutions.

Respectfully Submitted,

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33 S&P Global Market Intelligence, *Community Banks Face Regulatory Competitive Pressures to Alter Overdraft Policy*, (Jan. 17, 2023), *available at* https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/community-banks-face-regulatory-competitive-pressures-to-alter-overdraft-policy-73795971#:~:text=Community%20banks%20face%20regulatory%2C%20competitive%20pressures%20to%20alter%20overdraft%20policy,-Share&text=The%20regulatory%20and%20competitive%20pressures,to%20the%20nation's%20smallest%20institutions.

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