State of California
Office of the Attorney General

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ATTORNEY GENERAL

February 20, 2024

RE: Surprise Overdraft Fees and Returned Deposited Item Fees

Dear California Banks and Credit Unions:

I write to encourage your institution to review its policies and practices regarding two types of fees that some financial institutions charge their customers: (1) surprise overdraft fees, which are assessed even when a consumer cannot reasonably anticipate that a debit or checking transaction will overdraw their account; and (2) returned deposited item fees, which are assessed when a consumer deposits a check that is returned, even when the consumer has no knowledge of or control over the circumstances that caused the check to be returned. These fees cause significant financial harm to California's most vulnerable consumers. The charging of these types of fees is likely an unfair business practice that violates the Unfair Competition Law[1] and the Consumer Financial Protection Act.[2]

RELEVANT LAWS

The Unfair Competition Law (UCL) prohibits unfair, unlawful, and fraudulent business acts and practices.[3] A business act or practice is unfair if "the gravity of the harm to the alleged victim" outweighs "the utility of the defendant's conduct."[4]

The Consumer Financial Protection Act (CFPA) also prohibits unfair, deceptive, or abusive acts or practices by any institution that provides consumer financial products or services.[5] The CFPA defines an "unfair" act or practice as one that (A) "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers," and (B) "is not outweighed by countervailing benefits to consumers or to competition."[6]

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[1] Bus. & Prof. Code, § 17200 et seq.
[2] 15 U.S.C., § 5536.
[3] Bus. & Prof. Code, § 17200.
[4] *Candelore v. Tinder, Inc.* (2018) 19 Cal.App.5th 1138, 1155-1156.
[5] 15 U.S.C., § 5536(a).
[6] 15 U.S.C., § 5531(c)(1).

SURPRISE OVERDRAFT FEES

An overdraft fee is charged to a consumer when the consumer conducts a transaction with a check or debit card that exceeds the balance in the consumer's account. The consumer's financial institution will advance the funds to complete the transaction, debit the consumer's account, and charge the consumer an overdraft fee.[7] Some financial institutions charge up to $36 or more for each overdraft. Overdraft fees typically are a flat fee that is charged regardless of the amount overdrawn and are thus unrelated to the institution's actual credit risk—a $1 overdraft will incur the same fee as a $100 overdraft. According to the Consumer Financial Protection Bureau (CFPB), the median overdraft for a debit card transaction is for less than $26 and is repaid within three days.[8] In this situation, a $36 surprise overdraft fee amounts to an extremely high-interest loan to a consumer without the consumer's knowledge or consent.[9]

Consumers from economically disadvantaged households are more likely to incur overdraft fees, as are Black and Hispanic consumers.[10] Meanwhile, financial institutions nationwide generated over $7.7 billion in revenue from overdraft and NSF fees in 2022.[11] California-chartered banks and credit unions alone generated nearly $220 million in revenue from overdraft fees in 2022.[12] Some of these institutions have derived a substantial portion of their total income from overdraft and NSF fees.[13]

In many cases, overdraft fees cannot be reasonably anticipated by consumers due to the complexity of how transactions are processed and the time lag between when transactions are authorized and when they are ultimately settled against a consumer's account. For example, a consumer may reasonably believe they have sufficient funds in their account to complete a transaction based on the balances in their online or mobile banking applications and because

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[7] This is different than a non-sufficient funds (NSF) fee, where the institution declines to complete the transaction but will charge the consumer a fee for attempting to exceed their available balance.

[8] Consumer Financial Protection Bureau, *Fact Sheet: The CFPB's Proposed Rule To Curb Excessive Fees on Overdraft Loans by Very Large Banks and Close a Decades-old Loophole* (Jan. 17, 2024) p. 1, https://files.consumerfinance.gov/f/documents/cfpb_overdraft-credit-very-large-financial-institutions_fact-sheet_2024-01.pdf.

[9] *See ibid.*

[10] Consumer Financial Protection Bureau, *Overdraft and Nonsufficient Fund Fees: Insights from the Making Ends Meet Survey and Consumer Credit Panel*, CFPB Office of Research Publication No. 2023-9 (Dec. 19, 2023) pp. 22-23, https://files.consumerfinance.gov/f/documents/cfpb_overdraft-nsf-report_2023-12.pdf.

[11] Consumer Financial Protection Bureau, *Data Spotlight: Overdraft/NSF Revenue Down Nearly 50% Versus Pre-pandemic Levels*, (May 24, 2023) 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/.

[12] Department of Financial Protection & Innovation, *Annual Report of Income from Fees on Nonsufficient Funds and Overdraft Charges* (March 2023) https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/04/Annual-Report-of-Income-from-Fees-on-Nonsufficient-Funds-and-Overdraft-Charges_2023.pdf.

[13] *Ibid.*

their financial institution authorizes the transaction. Indeed, banks and credit unions market their online and mobile applications as providing up-to-date account information. However, these balances may not reflect previously authorized transactions or intervening transactions, such as recurring "auto-pay" debits or outstanding check drafts.

Thus, even though a consumer may have sufficient funds to complete a transaction, and have that transaction authorized by their financial institution, they may still be charged an overdraft fee because their account does not have sufficient funds when that transaction is settled due to intervening or previously authorized transactions. These transactions are sometimes referred to as "authorize positive, settle negative" (APSN). The complexity of how payments are processed, authorized, and settled by financial institutions make it difficult for the average consumer to make an informed decision on whether to use overdraft protection and incur an overdraft fee for any particular transaction. A significant portion of consumers who are charged an overdraft fee are surprised to have incurred the charge.[14]

The practice of charging surprise overdraft fees that cannot be reasonably anticipated by a consumer—such as fees assessed on APSN transactions—likely is an unfair business practice that violates the UCL and CFPA.

Surprise overdraft fees impose a significant and grave financial harm on consumers, particularly the economically disadvantaged consumers who are more likely to incur such a charge.[15] A $36 charge can be especially burdensome for a household that lives paycheck-to-paycheck. And these fees cannot be reasonably avoided because, by definition, the consumer does not expect to be charged such fees.

The financial harm imposed on consumers by surprise overdraft fees is not outweighed by any apparent utility or benefit to consumers or competition. While allowing a consumer to overdraw their account to complete a transaction may provide some benefit, in situations where the consumer does not anticipate an overdraft fee, the consumer has not been given an opportunity to make an informed decision on whether to pay for overdraft protection. Otherwise, a consumer could choose another form of payment (such as a credit card or cash), transfer funds into the account at issue, or simply choose not to complete the transaction.

Nor does the use of overdraft fee revenue to lower the "up-front" cost of checking accounts provide benefits to consumers or competition. Indeed, the use of such "back-end" fee pricing—which disproportionately increases banking costs for economically disadvantaged consumers and people of color—to lower "up-front" costs actually obscures the true cost of banking and makes it more difficult for consumers to compare financial products and services. Surprise overdraft fees do not benefit consumers or competition.

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[14] Consumer Financial Protection Bureau, *Overdraft and Nonsufficient Fund Fees: Insights from the Making Ends Meet Survey and Consumer Credit Panel*, CFPB Office of Research Publication No. 2023-9 (Dec. 19, 2023) pp. 13-14, https://files.consumerfinance.gov/f/documents/cfpb_overdraft-nsf-report_2023-12.pdf.

[15] *See, supra,* note 10.

The Consumer Financial Protection Bureau and other agencies have similarly concluded that charging surprise overdraft fees is an unfair business practice. The CFPB has issued guidance indicating that such surprise overdraft fees likely violate the CFPA[16] and has brought enforcement actions against several banks for charging overdraft fees on APSN transactions. Regions Bank agreed in a consent order to pay about $191 million in restitution and penalties for charging overdraft fees on APSN transactions, and Wells Fargo agreed to pay $200 million in restitution to affected consumers for surprise overdraft fees.[17] The CFPB has also recently issued a proposed rule that would subject *all* overdraft services at very large banks to the same regulations that govern consumer credit transactions, such Regulation Z of the Truth-In-Lending Act.[18]

The Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) have also both issued guidance to financial institutions indicating that the practice of charging surprise overdraft fees likely violates the CFPA and Section 5 of the Federal Trade Commission Act.[19]

RETURNED DEPOSITED ITEM FEES

A returned deposited item fee is charged to a consumer when the consumer deposits a check that is returned because the check cannot be processed against the check originator's account. A check may be returned because the check originator has insufficient funds, their account is closed, there is a stop payment order, or the signature or other information on the check is questionable, among other reasons. The consumer that deposits the check typically has no knowledge of or control over the circumstances that cause the check to be returned. For example, the consumer likely would not know whether the check originator has sufficient funds in their account or would have no control over the check originator requesting a stop payment

[16] Consumer Financial Protection Bureau, *Unanticipated Overdraft Fee Assessment Practices*, CFPB Circular 2022-06 (Oct. 26, 2022) https://files.consumerfinance.gov/f/documents/cfpb_unanticipated-overdraft-fee-assessment-practices_circular_2022-10.pdf.

[17] Consent Order, *In re: Regions Bank*, CFPB Admin. Proceeding, File No. 2022-CFPB-0008 (Sept. 28, 2022) https://files.consumerfinance.gov/f/documents/cfpb_Regions_Bank-_Consent-Order_2022-09.pdf; Consent Order, *In re: Wells Fargo Bank, N.A.*, CFPB Admin. Proceeding, File No. 2022-CFPB-0011 (Dec. 20, 2022) https://files.consumerfinance.gov/f/documents/cfpb_wells-fargo-na-2022_consent-order_2022-12.pdf.

[18] Proposed Rule, *Overdraft Lending: Very Large Financial Institutions*, Docket No. CFPB-2024-0002 (Jan. 17, 2024) https://files.consumerfinance.gov/f/documents/cfpb_overdraft-credit-very-large-financial-institutions_proposed-rule_2024-01.pdf.

[19] Federal Deposit Insurance Corporation, *Supervisory Guidance on Charging Overdraft Fees for Authorize Positive, Settle Negative Transactions* (April 26, 2023) https://www.fdic.gov/news/financial-institution-letters/2023/fil23019a.pdf; Office of the Comptroller of the Currency, *Overdraft Protection Programs: Risk Management Practices*, OCC Bulletin 2023-12 (April 26, 2023) https://www.occ.gov/news-issuances/bulletins/2023/bulletin-2023-12.html.

order. Yet some institutions will charge that consumer a returned deposited item fee (also referred to as a "depositor fee") up to $19 or more for depositing a check that is later returned.[20]

The practice of charging returned deposited item fees likely is an unfair business practice that violates the UCL. Charging such fees causes substantial harm to consumers that outweighs any potential utility or justification for the practice. A fee of up to $19 per returned deposited check causes significant monetary harm to consumers, especially those of limited financial means.

That harm is particularly grave because a consumer cannot reasonably avoid the injury in most instances. The consumer typically would not know if the check originator had sufficient funds in their bank account, whether the account was closed, or whether the signature on the check is valid. Indeed, the fact that a consumer deposits a check tends to show that the consumer believes the check is genuine—if the consumer knew that the check would be returned unfunded and that they would be charged a $19 fee, the consumer likely would not try to deposit the check. Nor would the average consumer have the ability to verify that the check originator has sufficient funds or to recoup the returned item fee from the check originator.

This harm is not outweighed by any apparent utility or benefit to consumers or competition. The individual consumer does not receive any extra service or benefit for the fee—they are simply penalized for unknowingly attempting to deposit a bad check. Nor is there any deterrence value associated with the fee because consumers, in most cases, have no idea that the check they are trying to deposit is bad. The fee cannot be justified as a recoupment of costs suffered by the financial institution; such fees are generally charged on every returned deposited check, regardless of whether the institution actually suffers any monetary loss itself.

Finally, to the extent that revenue from returned deposited item fees is used to lower the overall costs of consumer checking accounts, such "bank-end" fee pricing is actually harmful to the most vulnerable consumers, who are disproportionately assessed such fees. "Bank-end" pricing is also harmful to competition because it disguises the true cost of banking, making it harder for consumers to compare the financial services offered by different institutions.

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[20] Bulletin 2022–06: Unfair Returned Deposited Item Fee Assessment Practices, 87 Fed. Reg. 66,940 (Nov. 7, 2022).

The CFPB has also issued guidance indicating that the blanket practice of charging returned deposited item fees for every returned check likely is an unfair practice that violates the CFPA.[21] For the reasons stated above, and in the CFPB's guidance bulletin, such practices likely also violate the UCL.

Sincerely,

Rob Bonta
Attorney General

[21] *Ibid.*