American Bankers Association.

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The Honorable Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Gruenberg,

On behalf of the American Bankers Association[1] (ABA), I write to express the banking industry's concern with the Federal Deposit Insurance Corporation's (FDIC) issuance of guidance to announce new regulatory expectations for banks' nonsufficient funds (NSF) fee practices.

Our members value agency guidance that clarifies existing law and regulation, and we encourage the use of guidance for this purpose. However, bankers object to the issuance of guidance, without the opportunity for advance stakeholder comment, when that guidance changes existing law, regulation, or official commentary and is applied retrospectively. In 2021, the FDIC established new expectations—effectively changing existing law—regarding NSF fees through a Financial Institution Letter issued in August 2022[2] (FIL) and revised in June 2023[3] (Revised FIL).

As discussed in ABA's white paper, *Effective Agency Guidance*,[4] the issuance of these guidance documents reflects a failure to follow the mandatory process of the Administrative Procedure Act[5] (APA), which is required for guidance that is the equivalent of a binding "legislative rule." Under the APA, legislative rules must be the product of the "notice-and-comment" rulemaking process.[6] The agency must issue a proposal, seek public comment, and then publish a final rule that incorporates and responds to the comments received.[7] The FDIC failed to follow the APA's notice-and-comment process when issuing the FIL and Revised FIL, which we believe constitute legislative rules.[8] In fact, the FDIC does not have the authority to issue a rule that defines

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[1] The American Bankers Association is the voice of the nation's $23.4 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $18.6 trillion in deposits and extend $12.3 trillion in loans.
[2] Fed. Deposit Ins. Corp. (FDIC), Supervisory Guidance on Multiple Re-Presentment NSF Fees 3 (2022), https://www.fdic.gov/news/financial-institution-letters/2022/fil22040a.pdf [hereinafter, FIL].
[3] *Id.*, Supervisory Guidance on Multiple Re-Presentment NSF Fees (revised 2023), https://www.fdic.gov/news/financial-institution-letters/2023/fil23032a.pdf [hereinafter, Revised FIL].
[4] Am. Bankers Ass'n, *Effective Agency Guidance* (Feb. 6, 2024), https://www.aba.com/advocacy/policy-analysis/wp-effective-agency-guidance [hereinafter, *Effective Agency Guidance*].
[5] 5 U.S.C. § 553(b) & (c).
[6] *Id.*
[7] *Id.*
[8] In addition, as discussed in Part II of this letter, the FDIC lacks rulewriting authority to write a consumer protection rule regarding NSF fees.

specific acts or practices as unfair or deceptive under section 5 of the Federal Trade Commission (FTC) Act, as the FDIC effectively did in this case.[9]

By avoiding the rulemaking process, and even less formal outreach, the FDIC lost a valuable opportunity to obtain broad public feedback on the practical implications, costs, and benefits of the proposed policy change. This process encourages adoption of a regulatory framework that benefits both consumers and financial institutions as well as promotes public acceptance and the longevity of the regulatory policy change.

Equally concerning, the FDIC has applied the new expectations created by the FIL and Revised FIL retrospectively. Banks have been cited for violations of section 5 of the FTC Act for charging fees that were fully disclosed and completely lawful. They were required to conduct extensive reviews to identify and remediate customers for fees that were lawfully charged. Moreover, we note that the use and enforcement of "guidance" is contrary to the FDIC's binding regulations that prohibit enforcement based on supervisory guidance.[10]

We urge the FDIC to rescind the FIL and Revised FIL. These documents are legislative rules that the FDIC had no authority to issue. If the FDIC seeks to issue what is in fact guidance that advises FDIC-supervised banks about the agency's supervisory expectations with respect to charging represented NSF fees, the agency should do so only after providing notice and an opportunity for the public to comment on the draft guidance. The FDIC and other financial services regulators often seek comment on guidance before it is issued, even when the APA does not require it. Following this approach will lead to the issuance of guidance that minimizes operational challenges, facilitates compliance, and is more durable.

I. Background

When a merchant submits a check or ACH transaction initiated by a customer and the customer's account does not have sufficient funds to cover the payment, the bank may return the item to the merchant and charge an NSF fee. The fee covers the cost to process the return and serves as a penalty to encourage responsible deposit account management. A merchant has the right to resubmit the transaction to the bank with the expectation that the customer will have money in his account so that the transaction will be paid. If the account balance remains insufficient to pay the transaction, the bank may return it a second time and charge another NSF fee (Representment NSF Fee). A bank has no control over whether, or when, a merchant resubmits a transaction.

No statute or regulation prohibits a bank from charging a Representment NSF Fee when it returns a transaction presented against insufficient funds in the customer's account. Moreover, Regulation DD requires banks to disclose the NSF fees they charge.[11] But in 2021, FDIC examiners—without warning—began scrutinizing account disclosures to determine whether they adequately (in the judgment of the examiner/agency) informed consumers that they could be

[9] *See* Federal Trade Commission Act, § 5, *codified at* 15 U.S.C. § 45.
[10] *See* 12 C.F.R. § pt. 302 (App. A).
[11] NSF fees, like other deposit account fees, are governed by the Truth in Savings Act disclosure rules as implemented by Regulation DD. *See* Reg. DD, 12 C.F.R. § 230.4(a)(4) (requiring banks to disclose the "amount of any fee that may be imposed in connection with the account (or an explanation of how the fee will be determined) and the conditions under which the fee may be imposed").

charged Representment NSF Fees. If not, the FDIC began citing banks for a "deceptive" act or practice under section 5 of the FTC Act.

After assessing UDAP violations and without undertaking notice and comment rulemaking or soliciting stakeholder feedback, the FDIC issued the FIL in August 2022[12] and, subsequently, the Revised FIL in June 2023[13] to nearly 3,000 financial institutions under its direct supervision.[14] The FIL directed FDIC-supervised institutions to "self-identify" allegedly flawed customer agreements and to provide restitution to impacted customers.[15] The FIL and supervisory examinations made clear that banks must provide new representment disclosure language in customer agreements to avoid a deception finding.[16] The FDIC's restitution requirement in the FIL has led institutions to conduct a manual, time-intensive "lookback" process to identify represented transactions in customers' accounts over a multi-year period.[17] Also, regardless of the clarity of the disclosures given to consumers, the FIL states that "multiple NSF fees . . . assessed for the same transaction in a short period of time without sufficient notice or opportunity for customers to bring their account to a positive balance" may be considered unfair.[18] Thus, the FIL makes clear that following the FDIC's new disclosure requirements does not protect an institution from an "unfairness" claim by the FDIC.[19] We also note that the FDIC has cited banks for UDAP violations on the basis of the FIL and Revised FIL despite a prohibition in the agency's regulations against taking enforcement actions based on supervisory guidance."[20]

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[12] FDIC, FIL, *supra* note 2.
[13] *Id.*, Revised FIL, *supra* note 3.
[14] FDIC, BankFind Suite: Find Institution Financial & Regulatory Data, https://banks.data.fdic.gov/bankfind-suite/financialreporting (calculating 2,989 institutions where the FDIC is the institution's primary Federal regulator, as of June 30, 2023).
[15] *Id.*, FIL, *supra* note 2, at 3.
[16] *See id.* at 1.
[17] For additional explanation of banks' processes for conducting required lookbacks, see footnote 37 and accompanying text.
[18] *Id.* at 2.
[19] Regrettably, the Office of the Comptroller of the Currency, the Federal Reserve Board of Governors, and the Consumer Financial Protection Bureau decided to follow the FDIC's approach and scrutinize banks' decisions to charge Representment NSF Fees. All three agencies went beyond the FDIC's focus on disclosures and began citing banks for unfairness violations. Specifically, in March 2023, the Bureau issued a Supervisory Highlights publication that stated that examiners have found that banks engaged in unfair acts or practices in violation of section 1031 of the Dodd-Frank Act (UDAAP) by charging Representment NSF Fees. Consumer Fin. Prot. Bureau (Bureau), Supervisory Highlights: Junk Fees Special Edition, Issue 29, Winter 2023, at 5-6 (Mar. 2023), https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights-junk-fees-special-edition_2023-03.pdf. In April 2023, the OCC issued a bulletin that similarly stated that the agency has issued findings that the practice of charging these fees "was unfair and deceptive." Office of the Comptroller of the Currency (OCC), Overdraft Protection Programs: Risk Management Practices, OCC Bulletin 2023-12, at 6 (2023), https://occ.gov/news-issuances/bulletins/2023/bulletin-2023-12.html. Finally, in September 2023, the Federal Reserve issued a "Compliance Spotlight" that stated that the agency's "examiners cited the assessment of NSF fees on represented transactions as an unfair practice in violation of section 5" of the FTC Act. Bd. of Govs. of the Fed. Reserve Sys. (Federal Reserve), Compliance Spotlight – Supervisory Observations on Representment Fees (2023), https://www.consumercomplianceoutlook.org/2023/second-issue/compliance-spotlight/.
[20] *See* 12 C.F.R. § pt. 302 (App. A).

II. The FIL and Revised FIL Constitute Unauthorized Rulemaking in Violation of the Administrative Procedure Act

Despite the FDIC's characterization of the FIL and Revised FIL as supervisory guidance, they are legislative rules that should have gone through notice-and-comment rulemaking because they established a binding norm, limited the FDIC's discretion, and imposed new obligations on banks. However, the FDIC did not go through the required notice-and-comment process and, in fact, does not have authority to define specific acts or practices as unfair or deceptive. Instead, Congress vested the Federal Trade Commission and CFPB with this authority.[21] All of the above leads one to the inescapable conclusion that the FDIC violated the APA when it issued the FIL and Revised FIL.[22]

As discussed in ABA's white paper, *Effective Agency Guidance*,[23] the APA mandates that legislative rules go through the notice-and-comment process.[24] The touchstone of a legislative rule is that it imposes "legally binding obligations" on regulated entities.[25] The "binding" nature of a legislative rule can be determined if the agency action leaves the agency with no discretion[26] or "creates new rights or imposes new obligations on regulated parties . . . ."[27] And before an agency may issue a final legislative rule, the agency must issue a proposal, provide an opportunity for the public to provide written comment, and then respond to the comments submitted when issuing the final rule.[28]

Against this standard, the FIL and Revised FIL clearly are legislative rules. Consider first that, prior to 2021, the FDIC did not subject the Representment NSF Fee practices of banks under the FDIC's supervision to negative scrutiny. As described above, the FIL and Revised FIL impose new obligations on banks and, on this basis alone, the actions are legislative rules.

Moreover, in the Revised FIL, the FDIC established a binding norm by prescribing the actions that supervised institutions must take regarding Representment NSF Fees to avoid being cited for a "deceptive" act or practice. The FDIC stated that it "expects" financial institutions to "[t]ake full corrective action" to remedy allegedly inadequate disclosures and that, if there is a "likelihood of substantial consumer harm," the agency will require a "lookback review" and that the bank provide restitution to impacted customers.[29]

The Revised FIL limited the FDIC's discretion in assessing banks' Representment NSF Fee practices by obligating the agency to enforce the terms of the Revised FIL. The Revised FIL

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[21] *See* 15 U.S.C. § 57a(a)(1)(B) (providing FTC with UDAP rulewriting authority); 12 U.S.C. § 5531(b) (providing Bureau with UDAAP rulewriting authority). The FDIC has UDAP enforcement authority over the banks it supervises, *see* 12 U.S.C. § 1818, but does not have authority to define specific unfair or deceptive acts or practices.
[22] *See* 5 U.S.C. § 706(2)(C) (providing that a reviewing court shall hold unlawful any agency action that is in excess of the agency's statutory authority).
[23] ABA, *Effective Agency Guidance*, *supra* note 4, at 4.
[24] 5 U.S.C. § 553(b) & (c).
[25] *Nat'l Mining Ass'n v. McCarthy*, 758 F.3d 243, 251 (D.C. Cir. 2014) (Kavanaugh, C.J.); *see also Cmty. Nutrition Inst. v. Young*, 818 F.2d 943, 946 & 946 n.4 (D.C. Cir. 1987) (per curiam) (holding that "if a statement has a present-day binding effect, it is legislative").
[26] *See Cmty. Nutrition Inst.*, 818 F.2d at 946.
[27] *Ass'n of Flight Attendants-CWA v. Huerta*, 785 F.3d 710, 717 (D.C. Cir. 2015).
[28] 5 U.S.C. § 553(b) & (c).
[29] FDIC, Revised FIL, *supra* note 3, at 3 & 4 n.4. The FDIC suggests, but does not state, that the lookback period is two years. *Id.* at 4 n.4.

states that the "supervisory response *will* focus on identifying re-presentment related issues and *ensuring* correction of deficiencies and remediation to harmed customers, when appropriate."[30] Further, the FDIC "will evaluate appropriate supervisory or enforcement actions" against banks that have not strengthened their Representment NSF Fee disclosures, based on the new rules established in the Revised FIL.[31] ABA members have reported that their examiners believe the FIL (and, subsequently, the Revised FIL) leave examiners with no discretion. An examiner must cite a bank for a deceptive practice if the bank recently strengthened its disclosure in a manner that suggests the bank believes its prior disclosure was inadequate under the FDIC's new interpretation of Representment NSF Fee disclosure requirements.

As discussed in *Effective Agency Guidance*, the FDIC, as a financial services regulator, must take special care when issuing guidance. Participants in highly regulated industries like banking "often face overwhelming practical pressure to follow what a guidance document 'suggests.'"[32] Banks are subject to regular supervision and consider it important to avoid disagreements with examiners. Thus, banks reasonably viewed the FIL as binding on them.[33]

All of the above makes clear that the FIL and Revised FIL established a binding norm, limited the FDIC's discretion, and imposed new obligations on banks under the threat of supervisory or enforcement action. Therefore, they are legislative rules that should have gone through the APA notice and comment process but did not, presumably because the FDIC did not have statutory authority to issue a UDAP rule. Therefore, the FDIC must rescind the FILs.

If the FDIC seeks to issue guidance that advises FDIC-supervised banks about the agency's supervisory expectations regarding Representment NSF Fees, the agency should describe the facts and circumstances that could increase the risk that a bank's practices could be deemed deceptive or unfair under existing law. However, the guidance may not go beyond the requirements of existing rules or otherwise create new obligations for supervised banks.

III. The FDIC's Failure to Seek Public Comment Not Only Violated the APA, It Meant the Agencies Did Not Address the Operational and Practical Issues Presented by the Policy Change

As noted in *Effective Agency Guidance*, when issuing guidance—particularly guidance that articulates the agency's interpretation of regulatory requirements and describes how it will exercise enforcement discretion—the agency should seek comment.[34] If the FDIC had sought comment prior to proposing a change in its approach to Representment NSF Fees, the agency would have learned that merchants—not banks—are best positioned to control whether and when a transaction is resubmitted for payment. The FDIC also would have learned that identification of a represented transaction required the development of a core-provided solution, underscoring the need for a sufficient implementation period. A request for comment on the proposed policy

[30] *Id.* at 3 (emphasis added).
[31] *Id.* at 4.
[32] ABA, *Effective Agency Guidance*, *supra* note 4, at 5 (quoting Nicholas R. Parrillo, *Federal Agency Guidance and the Power to Bind: An Empirical Study of Agencies and Industries*, 36 Yale J. Reg. 165, 174 (2019)).
[33] *See* ABA, *Effective Agency Guidance*, *supra* note 4, at 5-6. As we stated in the white paper, our concerns with guidance that banks view as effectively binding on them is "not merely a theoretical concern; 'Operation Choke Point' leveraged regulatory guidance from the FDIC to pressure banks to stop providing services to business in legal industries that were disfavored by regulators. Many banks, not wanting to upset their regulators, complied." *Id.* at 6.
[34] *See id.* at 3-4 & 11-14.

change also would have given the FDIC the time to consider adopting model disclosures and the opportunity to test draft disclosures with consumers.

a. Merchants—Not Banks—Are in the Best Position to Control Whether and When a Transaction Is Resubmitted for Payment

If the FDIC published draft guidance and requested comment prior to issuing the FIL, industry would have urged the agency to consider the broader regulatory framework governing how banks must process transactions submitted to them by merchants. This framework is underpinned by two critical facts. First, banks are obligated to process transactions and either pay or return the transaction in accordance with the laws and rules applicable to the type of payment presented to the bank. Second, merchants—not banks—control whether and when a transaction is resubmitted. Had the FDIC sought comment, it could have considered these factors when determining whether to impose additional obligations on banks with respect to represented transactions.

When a transaction is returned to a merchant by the payor's bank, it is the merchant—not the bank—who decides whether to resubmit the transaction, the timing of that resubmission (e.g., resubmission after one day, two days, or another period of time), and the amount of the payment to re-present. ABA members report that merchants typically resubmit transactions three days after initial presentment, but this time period can vary substantially. Consistent with the rules established by the organization that governs the Automated Clearing House Network (NACHA), a bank treats each resubmission as a new item for processing purposes. Banks are required under NACHA rules, as well as under the bank's deposit agreement with its customer, to pay or decline payment transactions presented by a merchant.[35]

Other bank regulators have determined that the merchant is in the best position to control whether and when the transaction is resubmitted for payment. With respect to check transactions, the Federal Reserve requires the merchant, not the bank, to "obtain a consumer's authorization for each transfer"[36] – i.e., for each check submitted for payment – and to "provide a notice" if the check will be submitted as an ACH transaction[37] or if the merchant seeks to collect a returned check fee from the consumer if the check is returned unpaid.[38] Similarly, in the context of payments made to satisfy payday loans, the CFPB under then-Director Richard Cordray acknowledged that the entity submitting the transaction for payment (the payday lender) is in the best position to control whether and when a transaction is resubmitted.[39]

The FDIC did not reference this regulatory framework and the interplay between that framework and the agency's proposed policy change regarding represented transactions. If the FDIC had

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[35] *See* 2023 Nacha Operating Rules & Guidelines, § 3.3 (providing timing requirements for banks to make credits and debits available to customers).

[36] 12 C.F.R. § 1005.3(b)(2)(ii).

[37] *Id.*

[38] *Id.*, § 1005.3(b)(3).

[39] Payday lenders seek payment on a payday loan by cashing the borrower's check. When the borrower has insufficient funds in his or her bank account, the check is returned to the payday lender, and the borrower may be assessed an NSF fee. To reduce the number of these NSF fees, the CFPB issued a rule that prohibited the lender from attempting to withdraw payment on the loan (i.e., cash the borrower's check) after two unsuccessful withdrawal attempts. The CFPB thus imposed obligations on the entity that had control over whether and when the transaction would be resubmitted (the lender), not on the financial institution that received the transaction (the bank). *See* Payday, Vehicle Title, and Certain High-Cost Installment Loans, 82 Fed. Reg. 54,472 (Nov. 17, 2017).

sought comment, it might have considered whether the FDIC's concerns with Representment NSF Fees were better addressed by examining merchant representment practices than by limiting when banks may charge Representment NSF Fees.

b. Compliance With the FILs Required Considerable Time for the Development of Core-Provided Solutions and the Review and Revision of Disclosures

When the FDIC published the FIL, a bank had no way to know with certainty that a transaction had previously been presented for payment using a core provider's off-the-shelf solution. Yet, the FIL (and, subsequently, the Revised FIL) stated that banks risked being cited for an unfairness violation if they continued to charge Representment NSF Fees. If the FDIC had sought comment, it would have learned this fact and that the development of solutions to identify these transactions would take a considerable period of time. Indeed, the core providers did not begin providing solutions until spring 2023—nearly two years after the FDIC first began scrutinizing banks' Representment NSF Fee practices.

The rules, procedures, and practices that govern how ACH and check transactions are submitted and processed are complex. Put simply, this framework was not designed to allow banks to consistently identify represented transactions.[40] As of the date of this letter, many banks still do not have access to core products that allow the bank to systematically identify represented transactions. And even when a core-provided product is available, the merchant must have coded the transaction properly for the core's product to accurately identify the transaction. In addition, the bank may need to have an employee review each NSF transaction to confirm that a fee is assessed or not assessed as appropriate. Because the FIL was issued without advance notice and the opportunity for comment, the FDIC did not consider the costs that the FIL would impose on banks and whether those costs are justified.

The FDIC did not acknowledge the complex and highly technical framework for identifying and processing transactions described above. Accordingly, the FDIC provided no implementation period for the FIL, and banks had limited ability to comply with the FIL's expectations until the cores provided solutions two years later (beginning in spring 2023). If the FDIC had requested

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[40] With respect to ACH transactions, NACHA's rules require originators of an ACH transaction to populate the company/entry description field with the value "RETRY PYMT" in any re-initiated transaction. We understand that one purpose of the use of this phrase "RETRY PYMT" is to allow the bank to identify resubmitted transactions. However, bankers reported that, at the time of the FIL's issuance, it was not functionally possible for banks to run alerts against the description field to identify a resubmitted transaction using standard transaction processing technology developed by the core processors.

Moreover, the bank's identification of a transaction as a representment is predicated on the merchant properly coding the transaction as "RETRY PYMT." Merchants use a long list of codes to label transactions, including re-initiated transactions, and merchants do not consistently use one code to signal that an ACH item is being resubmitted. For example, a merchant may use the code "ACH return" to signal a resubmitted item, a customer's return of the good or service purchased, or a "bad" transaction.

With respect to check transactions, the magnetic ink character recognition (MICR) line on the check provides the check number. Therefore, the bank could search manually for specific check numbers to determine if a check had previously been presented for payment. However, bankers report there was (and continues to be) no automated means to identify resubmitted checks. In addition, a check can be resubmitted as an ACH transaction, which makes it more difficult for the bank to determine whether the item has been presented previously when it is resubmitted as an ACH.

comment on draft guidance, stakeholders could have explained these challenges and presumably the FDIC would have given industry a reasonable implementation period. Similarly, had the FDIC invited comment, banks would have advocated for model disclosures under Regulation DD, which could have been developed through consumer testing to ensure their effectiveness.

IV. The FDIC Should Not Have Applied New Expectations Retrospectively

A central failing of the FIL and Revised FIL is that the FDIC applied its new expectations regarding Representment NSF Fees retrospectively.[41] In short, the FDIC applied its new expectation to past conduct that, at the time of the conduct, had not been subject to any regulator criticism. In some cases, banks that had already ceased charging Representment NSF Fees at the time of its examination were advised they would nonetheless be cited for a UDAP violation for their past practices.

This approach is inherently unfair to supervised banks because they have no advance notice of the alleged illegality of their actions. Therefore, banks had no opportunity to change their course of conduct – i.e., to work with its core provider to update disclosures or cease charging Representment NSF Fees – to conform with the FDIC's new expectations.

We urge the FDIC not to announce new expectations regarding a financial institution's conduct – whether through guidance, rulemaking, or another agency action – and then criticize the institution for past practices that complied with the agency's expectations in place during the time period when the conduct occurred. Instead, when setting new supervisory expectations, agencies should propose the new expectation, seek feedback (comment) from regulated entities on the new expectation (including potential costs and implementation challenges of the new expectation), and then finalize the new expectation. Once the new expectation is finalized, regulated entities should be provided with sufficient time to modify their policies and procedures to align with the new expectation.

Conclusion

The FDIC has established binding rules for banks without statutory authority, and without undergoing the APA's rulemaking process. The FDIC also has applied the new expectations created by these policy actions retrospectively, citing banks for UDAP violations for conduct that conformed to then-existing agency expectations and, in some cases, requiring the bank to provide restitution to impacted customers over a lookback period.

If the FDIC had sought comment before taking this action, it would have understood and presumably would have addressed the significant operational and practical issues presented by its policy change. We urge the FDIC to use guidance only as a means to clarify existing law, not establish new law. We also urge the FDIC to seek comment prior to issuing guidance in the

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[41] Notably, the Federal Reserve has applied its similar expectations prospectively only, and not retrospectively. When the Federal Reserve issued its Compliance Spotlight in fall 2023, ABA members who are supervised by the Federal Reserve reported that the agency was not citing banks that were currently in examinations for unfairness UDAP violations for charging Representment NSF Fees. According to these banks, the Federal Reserve stated that it will cite banks for an unfairness UDAP violation only if, at the time of the Federal Reserve's future examination of the bank, the bank has not ceased charging Representment NSF Fees.

future. Following these recommendations will lead to the issuance of more durable, effective guidance.

Sincerely,

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Consumer & Regulatory Compliance
Regulatory Compliance and Policy