CFPB Proposal to Apply Regulation Z to Overdraft Services

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Issue Update

On January 17, 2024, the Consumer Financial Protection Bureau issued a proposal to impose additional restrictions on overdraft protection services, as part of its effort to reduce or eliminate fees that it believes are "junk fees." The proposal would apply the Truth in Lending Act (TILA) and Regulation Z requirements to overdraft protection services offered by banks and credit unions with assets in excess of $10 billion that charge an overdraft fee above a certain dollar threshold. An institution would be exempt from this application of Regulation Z only if it charges a "true courtesy" fee using one of the two calculations: (1) a fee that reflects the institution's "breakeven" costs, including charge-off losses, to operate its overdraft program; or (2) a fee that conforms to a "benchmark" fee set by the CFPB. The Bureau has proposed $3, $6, $7, or $14 as potential benchmarks.

For covered overdraft "credit," the proposal also would prohibit institutions from offsetting incoming credits to the customer's account as repayment for the overdrawn amount and from requiring customers to use preauthorized electronic fund transfers (EFTs) to repay an overdraft through an automatic debit from the customer's deposit account. In addition, the proposal would apply the CARD Act's provisions to overdrafts that the customer accesses through a debit card (which the proposal calls a "hybrid debit-credit card"), including the Act's requirement to conduct an ability-to-pay determination. The proposal also appears to prohibit all NSF fees on ACH transactions.

Why It Matters

ABA survey data and consumer use demonstrate that overdraft provides an important form of short-term liquidity to customers, ensuring that important payments such as rent, mortgages, car loans, and utilities, are made on time, and that customers avoid utility shut-off or eviction. For example, 88% of consumers find their bank's overdraft protection valuable, and 77% who paid an overdraft fee were glad their bank covered their payment, rather than returning or declining it. When banks pay the overdraft rather than return an item, consumers also avoid the fee imposed by the payment recipient.

The Federal Reserve's 2009 "opt-in" rule ensures that consumers have the information necessary to make informed and deliberate choices regarding overdraft. Consumers must "opt in" before banks may charge fees for overdrafts resulting from one-time debit card and ATM transactions. Consumers may opt out at any time. In the years following the 2009 rule, banks have provided an increasing number of ways for customers to limit or avoid overdraft fees. These include sending low-balance alerts, linking the customer's checking account to another account, imposing *de minimis* thresholds and caps on total fees that the bank may charge per day, and providing overdraft "grace periods" during which a customer can make a deposit and avoid a fee. Some banks have announced they no longer charge overdraft or NSF fees. Many banks now offer overdraft-free accounts that meet the Bank On initiative's National Account Standards.

If the proposal is finalized, banks will likely reduce their overdraft fee to the CFPB's benchmark fee, rather than assume the compliance risks and costs associated with calculating the bank's breakeven fee, conducting an ability-to-pay determination, or losing the ability to offset incoming credits to the customer's account to repay the overdrawn amount. Banks may not offer overdraft services at all, depriving consumers of an important form of liquidity and leading them to turn to nonbank providers. A 2021 New York Federal Reserve Bank study found that "overdraft fee caps hamper, rather than foster, financial inclusion" by limiting access to deposit accounts.

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Recommended Action Items

- Emphasize to policymakers that the proposal harms consumers. Banks may choose not to offer overdraft, rather than set fees at the government's price cap. Not all customers will qualify for an overdraft line of credit. The government's own study found that overdraft fee caps reduce the supply of deposit accounts.
- Ask if the CFPB considered that smaller banks will face competitive pressure to conform to the CFPB's rule. Banks that cannot sustainably offer overdraft services at the benchmark fee may exit the market.
- ASK the CFPB if they consulted with the other banking regulators, as the CFPB is required to do under the Dodd-Frank Act.

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