Institute for Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

April 1, 2024

To: Consumer Financial Protection Bureau

Re: Overdraft Lending: Very Large Financial Institutions, 89 Fed. Reg. 13,852 (proposed Feb. 23, 2024) (CFPB-2024-0002)

The Institute for Policy Integrity at New York University School of Law (Policy Integrity)[1] respectfully submits this comment letter on the Consumer Financial Protection Bureau's (CFPB) proposal, Overdraft Lending: Very Large Financial Institutions (Proposed Rule).[2] Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy.

The Proposed Rule reflects a well-reasoned approach to correct market failures in the overdraft credit market, which will also mitigate the harms to consumers from expensive overdraft fees. However, CFPB could take several steps to strengthen its explanation of its statutory authority to issue this regulation and its justifications for its method of regulation. Specifically, we make the following recommendations:

- **CFPB should lay out in further detail that it has always had clear statutory authority to regulate overdraft credit.** CFPB should clarify how regulating overdraft credit falls well inside its existing statutory limits and that it is merely narrowing the scope of a longstanding regulatory exemption.

- **The Proposed Rule reflects a reasoned and justified change from prior regulations.** To more clearly justify its change in policy, CFPB should concisely organize its justifications for restricting the overdraft exemption and recognize its authority to regulate incrementally, starting with the largest financial institutions.

- **To calculate benchmark fees, CFPB should consider average, rather than high-end, charge-off rates and recognize that the \$6 and \$14 options are overestimates of the breakeven point.** Using the highest charge-off rates—as opposed to average charge-off rates—to calculate benchmark fees will sacrifice consumer benefits for likely only small gains in compliance and administrative costs. And if banks are acting in a rational and profit-maximizing way, the pool of overdrafts where the fee is waived ("waived overdrafts") is different from that of overdrafts where a fee is paid ("charged overdrafts"). CFPB should therefore consider the average net costs of only charged overdrafts, meaning the \$6 and \$14 benchmark options overestimate the breakeven point.

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[1] This document does not purport to present the views, if any, of New York University School of Law.
[2] Overdraft Lending: Very Large Financial Institutions, 89 Fed. Reg. 13,852 (proposed Feb. 23, 2024) (to be codified at 12 C.F.R. pts. 1005, 1026) [hereinafter Proposed Rule].

- **CFPB should clearly identify relevant market failures, such as information asymmetry and behavioral biases**, and explain how the Proposed Rule is intended to remedy them.
- **CFPB should recognize that distributional effects further justify the Proposed Rule.** Because frequent overdrafters are likely to be low-income, transfer of benefits to these consumers is likely to improve social welfare rather than be zero-sum.

Following a short background section, we expand upon these points below.

Background

The Proposed Rule seeks to regulate overdraft fees charged by very large financial institutions (VLFIs).[3] The Proposed Rule would narrow regulatory exemptions that have enabled banks extending overdraft credit to avoid complying with the regulatory requirements otherwise imposed on credit products.[4] Overdraft credit (and its regulatory exemptions) emerged in a check-centric environment where banks offered the service as a courtesy to consumers to avoid the consequences of a bounced check.[5] Fueled by these regulatory exemptions and the modernization of financial tools—namely debit cards—overdraft credit has expanded from an infrequent accommodation into a substantial revenue source for financial institutions.[6] Typical overdraft fees are approximately $35 per transaction and the source of billions of dollars of revenue for banks.[7]

CFPB proposes to require VLFIs charging overdraft fees above "breakeven overdraft credit"—defined as overdraft credit provided at or below costs and losses—to comply with disclosure obligations and protections that apply to other forms of credit.[8] Alternatively, the VLFI may choose from one of two options to set an overdraft fee at or below breakeven overdraft credit such that it is not required to comply with these obligations: (1) calculate its own costs and losses according to a "breakeven standard" defined by the Proposed Rule, or (2) charge fees at a benchmark level set as a default by CFPB.[9] Under the Proposed Rule, above-breakeven overdraft credit would be subject to Regulation Z, which requires various disclosures (such as Annual Percentage Rates (APRs)), payment terms, and advertising rules.[10] The Proposed Rule would also treat debit cards that can access covered overdraft credit as credit cards, subjecting them to existing regulations including ability-to-pay requirements, limitations on fees, and transparency around rate changes.[11]

All the major changes proposed in this rule share a similar statutory basis. The language of various consumer financial protection laws—most notably the Truth in Lending Act (TILA), as

[3] Proposed Rule, 89 Fed. Reg. at 13,853. VLFIs are defined as "insured depository institutions and credit unions with more than $10 billion in assets." *Id.*
[4] *Id.* at 13,853–54.
[5] *Id.* at 13,853.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*

amended by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act)—include overdraft credit within their scope. Yet for policy reasons, federal regulators have historically exempted overdraft credit from these regulatory regimes.[12] CFPB is now proposing to narrow this overdraft credit exemption for VLFIs, regulating above-breakeven overdraft credit in the same way as other credit services.

I. CFPB has clear statutory authority to regulate overdraft credit and should lay out that authority in further detail.

Some commentators have framed the Proposed Rule as based on a novel and tenuous extension of CFPB's statutory authority under various financial protection laws, principally TILA and the CARD Act.[13] However, the Proposed Rule merely narrows existing regulatory exemptions from these statutes' requirements. CFPB should further bolster its claims of statutory authority to subject covered overdraft fees to longstanding consumer financial protection regulations.

A. CFPB should clarify that it has always had the authority to regulate overdraft credit under TILA.

Congress passed TILA so that "consumer[s] will be able to compare more readily the various credit terms available to [them] and avoid the uninformed use of credit, and to protect . . . against inaccurate and unfair credit billing and credit card practices."[14] The legislation mandates that lenders provide standardized disclosures about borrowing terms and costs, ensuring that the methods used to calculate and present the expenses associated with obtaining credit are consistent from bank to bank.[15] CFPB should clarify that it has always had the authority to regulate overdraft credit under TILA.

TILA defines certain key terms broadly and in a manner that includes overdraft credit. For example, in delineating the costs of lending to be disclosed and standardized, the statute defines "finance charge" as the "sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. . . . [and] does not include charges of a type payable in a comparable cash transaction."[16] Similarly, the legislation defines "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment."[17] As the Proposed Rule notes, nowhere in the legislation did Congress speak to excluding overdraft credit from the scope of these broad terms.[18]

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[12] *See e.g.* 12 C.F.R. § 1026.2(a)(15)(ii) (exempting overdraft credit accessed by a debit card); 12 C.F.R. § 1026.4(c)(3) (exempting overdraft credit without a preexisting agreement from qualifying as a "finance charge"); 12 C.F.R. §1005.10(e)(1) (exempting overdraft credit from regulations preventing the compulsory use of a preauthorized electronic fund transfers).
[13] *See e.g.* Jeanne Sahadi, *Biden Administration Proposes Rule That Could Save Consumers $3.5 Billion a Year in Bank Fees*, CNN (Jan. 17, 2024), https://www.cnn.com/2024/01/17/success/bank-overdraft-fees-cfpb/index.html.
[14] 15 U.S.C. § 1601(a).
[15] *See* Pub. L. 90-321, 82 Stat. 146 (May 29, 1968), codified as amended at 15 U.S.C. 1601 *et seq*.
[16] 15 U.S.C. § 1605(a).
[17] 15 U.S.C. § 1602(f).
[18] Proposed Rule, 89 Fed. Reg. at 13,866 (citing Pub. L. 90-321, 82 Stat. 146 (May 29, 1968), codified as amended at 15 U.S.C. 1601 et seq.)

When the Federal Reserve Board (Board) promulgated Regulation Z in 1969 to implement TILA, it opted to exempt overdraft credit that had not been previously agreed upon in writing between a financial institution and consumer.[19] It did so by removing such credit from the scope of what was a "finance charge."[20] The term "finance charge" contained no such limitation in its definition under TILA. (CFPB has since assumed the Board's authority under TILA.[21]) As the Proposed Rule notes, nothing in the Board's exemption suggested that it was based on an interpretation of the statute.

Accordingly, there is no indication that the exemption was based on the scope of the Board's legal authority under TILA, rather than on policy considerations. In other words, CFPB claims no new statutory authority in the Proposed Rule. In fact, CFPB repeatedly notes that the exemption for overdraft comes from a regulatorily-created exemption, rather than TILA itself; the very first sentence of the Proposed Rule points this out.[22] However, CFPB can strengthen its explanation by elaborating on this key point. If the Board had the power to exempt overdraft credit from TILA in the first place, CFPB cannot be said to now lack the *power to narrow* this same exemption due to changing circumstances, particularly absent any affirmative statutory reason to the contrary.[23]

For example, CFPB's preliminary determination that, regulatory exemptions notwithstanding, covered overdraft credit would meet the required elements of "open-end credit" under Regulation Z is a thoughtful application of its criteria to overdraft.[24] It would be strengthened, however, by more explicitly articulating that this determination means **CFPB is not claiming any *new* authority under TILA; it is wielding authority that it has long been understood to possess.**

Because the effect of the Proposed Rule will be that a specific widespread financial services product faces regulatory scrutiny that it does not currently, it is easy to misinterpret the Proposed Rule as a new extension of regulatory authority, rather than the rollback of an agency-created exemption. Indeed, much public commentary has made this mistake. Therefore, it is particularly important for CFPB to highlight how it is applying longstanding regulatory provisions and merely narrowing the scope of exempted services. CFPB is bringing the regulatory scheme closer in line with TILA's plain textual meaning and should say so.

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[19] Truth in Lending, 34 Fed. Reg. 2002, 2004 (Feb. 11, 1969); Unfair or Deceptive Acts or Practices, 73 Fed. Reg 28,904, 28,927 (May 19, 2008) ("Historically, if a consumer engaged in a transaction that overdrew his or her account, depository institutions used their discretion on an ad hoc basis to pay the overdraft, usually imposing a fee. The Board recognized this longstanding practice when it initially adopted Regulation Z in 1969 to implement TILA.").

[20] Truth in Lending, 34 Fed. Reg. 2002, 2004 (Feb. 11, 1969).

[21] Pub. L. 111-203 § 1100(A)(b), 124 Stat. 1376 (2010).

[22] Proposed Rule, 89 Fed. Reg. at 13,852 ("This proposed rule would update non-statutory exceptions in Regulations Z and E that have allowed very large financial institutions to avoid statutory requirements when extending certain overdraft credit.").

[23] *Cf.* Nat'l Res. Def. Council v. Abraham, 355 F.3d 179, 202–03 (2d Cir. 2004) (though agencies lack "inherent power to reconsider final rules," they generally have authority "to amend or rescind a final rule" after following procedures as required" under the APA).

[24] Proposed Rule, 89 Fed. Reg. at 13,861–63.

B. Debit cards with overdraft features have always qualified as credit cards under TILA and the CARD Act.

CFPB should similarly underscore that, like overdraft credit generally, debit cards that access overdraft credit fall well within the purview of TILA, as amended by the CARD Act. The Proposed Rule explains how in 1981 the Board, to promote consistency with the general overdraft exemption created in 1969, exempted debit cards with no credit agreement, even if the cards accessed overdraft credit, from qualifying under Regulation Z's definition of "credit card."[25]

Congress then passed the CARD Act in 2009 to further regulate the credit card market under TILA.[26] TILA defines "credit card" as "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit."[27] In its changes to TILA, the CARD Act left this definition unaltered. Therefore, a debit card used to access overdraft credit, accompanied by a finance charge, qualifies as a "credit card" under the statutory definition.

The Proposed Rule references that in implementing the CARD Act in 2010 (immediately following the 2009 passage of the bill), regulators "believe[d] that, as a general matter, Congress intended the CARD Act to apply broadly to products that meet the definition of a credit card," including debit cards that access an overdraft line of credit.[28] Despite recognizing that such debit cards qualified as credit cards under the relevant statutory and regulatory definitions, the Board exempted them from CARD Act provisions in Regulation Z's subparts G and B.[29] To summarize, the Board and CFPB have long interpreted that debit cards that can access overdraft credit qualify as "credit cards" under TILA and the CARD Act. **The fact that such debit cards qualify under the statute led the Board to enact the various exemptions in the first place.**

Nonetheless, CFPB can strengthen the Proposed Rule by further highlighting the consistency of its interpretation. Additionally, CFPB can and should argue that undoing the exemptions brings the greater regulatory scheme closer to the plain meaning of the CARD Act, which applies to "credit card account[s] under an open-end consumer credit plan."[30]

C. To bolster its statutory authority, CFPB should draw explicit parallels between the Proposed Rule and the 2016 Prepaid Card Rule applying Regulation Z to prepaid cards.

While the Proposed Rule is new, its basic structure is not. It directly parallels CFPB's 2016 Rule, which extended Regulation Z to generally apply credit card regulations to prepaid accounts with credit features, including overdraft (Prepaid Rule).[31] CFPB should emphasize that the Proposed

[25] *See* Proposed Rule, 86 Fed. Reg. at 13,866–57; Truth in Lending; Official Staff Commentary, 46 Fed. Reg. 50,288, 50,293 (Oct. 9, 1981) (a "credit card" does not include "[a] check guarantee or debit card with no credit feature or agreement, even if the creditor occasionally honors an inadvertent overdraft"); *see also* Regulation Z comment 2(a)(15)–(2)(ii)(A)
[26] Pub. L. 111-24, 123 Stat. 1734 (2009).
[27] 15 U.S.C. § 1602(l).
[28] Proposed Rule, 86 Fed. Reg. at 13,875 (citing Truth in Lending, 75 Fed. Reg. 7658, 7664 (Feb. 22, 2010)).
[29] Truth in Lending, 75 Fed. Reg. 7658, 7664 (Feb. 22, 2010).
[30] Pub. L. 111-24, 123 Stat. 1734 (2009).
[31] *See* Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth in Lending Act (Regulation Z), 81 Fed. Reg. 83,934 (Nov. 22, 2016) [hereinafter Prepaid Rule].

Rule's application of the CARD Act regulations to hybrid debit-credit cards is merely an evolution of the Prepaid Rule, rather than a novel exercise of regulatory authority. While the Proposed Rule draws occasional parallels to the Prepaid Rule, CFPB should strengthen its arguments by grouping all the similarities in one place. Below, we provide a list of some key parallels between the Proposed Rule and the Prepaid Rule.

1. Narrowing of the overdraft exemption

The Prepaid Rule altered Regulation Z to regulate overdraft credit features offered in connection with prepaid accounts.[32] To do so, it amended the same regulatory provision as the Proposed Rule—Regulation Z's Section 1026.4(b).[33] More succinctly, just like the Proposed Rule, the Prepaid Rule took a category of financial services that were previously exempted from Regulation Z and amended the regulation's definitions of "finance charge" to bring them under the regulatory scheme.

2. Interpretation of "plan"

CFPB should elaborate on how its interpretation of "plan" is identical to the interpretation it offered in the Prepaid Rule, where it determined that overdraft services "can be regulated by Regulation Z as a 'plan' where the consumer is contractually obligated to repay the debt, even if the creditor retains, by contract, the discretion not to extend credit."[34] In the Proposed Rule, CFPB recognizes that credit card issuers "similarly reserve the right to reject individual transactions in their contractual agreements, yet credit card programs are treated as open-end credit plans under TILA and Regulation Z."[35] There is no reason why credit cards, but not overdraft credit, should meet this threshold notwithstanding institutional discretion to reject specific transactions. These consistent positions further support CFPB's determination that overdraft credit can qualify as a "plan" under Regulation Z.

3. Creation of "Hybrid" cards to clarify applicability under Regulation Z

Exactly like the Proposed Rule, the Prepaid Rule created a new term of "hybrid" cards that have credit card-like features, enabling them to be regulated under the provisions of Regulation Z governing credit cards.[36] In both cases, CFPB explained that it created the term to more cleanly delineate the products and services subject to the CARD Act regulations.[37]

4. Requirement to structure credit and assets separately in consumer accounts

Both the Prepaid Rule and the Proposed Rule require that the credit features of the products be organized separately from the asset features (prepaid funds and debit funds, respectively) to facilitate transparency and compliance with Regulation Z.[38] The Proposed Rule notes that this

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[32] *Id.* at 83,935, 84,369, 84,374.
[33] *Compare id.* at 84,180 *with* Proposed Rule, 89 Fed. Reg. at 13,864; *see* 12 C.F.R. § 1026.4.
[34] Prepaid Rule, 81 Fed. Reg. at 84,160 (Nov. 22, 2016).
[35] *Id*.
[36] Proposed Rule, 89 Fed. Reg. at 13,875–77; *see also* Prepaid Rule, 81 Fed. Reg. at 83,935–36.
[37] *Id.*; *see also* Prepaid Rule, 81 Fed. Reg. at 83,935–36, 83,979.
[38] Proposed Rule, 89 Fed. Reg. at 13,872; *see also* Prepaid Rule, 81 Fed. Reg. at 83,935.

requirement in the Prepaid Rule received uniformly positive comments when it was initially proposed.[39]

5. Application of compulsory use provision under Regulation E

The Prepaid Rule also updated the compulsory-use provision under Regulation E, prohibiting prepaid card providers from obligating consumers to establish pre-approved electronic fund transfers for repaying credit via overdraft credit functionality on a hybrid prepaid card.[40] The Proposed Rule would similarly prevent banks from requiring automatic repayment of overdraft credit through electronic fund transfers.[41] Instead, just as in the Prepaid Rule, the Proposed Rule would facilitate consumer autonomy by requiring a financial institution to provide customers with at least one alternative repayment method aside from payment by preauthorized electronic fund transfer.[42]

II. The Proposed Rule reflects a reasoned and justified change from prior regulations.

Throughout the Proposed Rule, CFPB offers many compelling reasons to support its revisions to consumer financial protection regulations. Although these justifications satisfy the legal requirements for modifying regulations, CFPB can further strengthen the presentation of its rationales for the Proposed Rule's changes. CFPB should also reaffirm its authority to regulate in incremental steps, which would further justify its decision to continue, at least for the time being, exempting overdraft credit services from small and midsize financial institutions.

A. CFPB should more clearly articulate its rationales for narrowing existing regulatory exemptions.

In *FCC v. Fox Television Stations*, the Supreme Court held that an agency revising previous regulations must offer a "reasoned explanation" for the change.[43] While CFPB offers sufficient explanation for its policy change in the Proposed Rule, it can expand upon that explanation in a few key areas to further limit legal risk.

CFPB should consider adding language to the rule's "Legal Authority" section (Section IV) that explains that **CFPB has consistently interpreted its claimed statutory authority over time**. The claim of statutory authority suggested in this comment's I.A and I.B should suffice to make clear that CFPB has ample authority to narrow a non-statutory exemption which was created by the Federal Reserve Board, whose authority under TILA CFPB inherited.

Throughout the Proposed Rule, CFPB offers many reasons in favor of its proposed changes, ranging from better furthering the purposes of the enabling statutes to aligning the exemption more rationally with its longstanding justifications and to a careful examination of costs and benefits. CFPB could strengthen its presentation of these rationales by inserting a single standalone section that summarized all the reasons that narrowing the overdraft exemption. Such

[39] Proposed Rule, 89 Fed. Reg. at 13,872 (citing Prepaid Rule, 81 Fed. Reg. at 84,264).
[40] Prepaid Rule, 81 Fed. Reg. at 83,935–36.
[41] Proposed Rule, 89 Fed. Reg. at 13,882–83.
[42] *Id*; *see also* Prepaid Rule, 81 Fed. Reg. at 83,981.
[43] FCC v. Fox Television Stations, Inc., 556 U.S. 502, 515–16 (2009).

a summary would help ensure that a final rule sufficiently articulates legally adequate reasons for a change in agency policy.

B. CFPB should explain that it can lawfully regulate incrementally, starting with Very Large Financial Institutions.

The Proposed Rule will apply only to VLFIs, leaving the overdraft exemption in place for many other institutions. Smaller financial institutions face different compliance challenges and will be monitored by CFPB while it considers whether and how to move forward with further regulation. This incremental approach to regulation is well within CFPB's authority.

It is well established that **agencies are not required to solve an entire problem all at once**, and CFPB should argue so specifically.[44] In *Massachusetts v. EPA*, the Supreme Court reaffirmed this longstanding principle of administrative law, noting "[a]gencies, like legislatures, do not generally resolve massive problems in one fell regulatory swoop."[45] Instead, they are empowered to "whittle away at them over time, refining their preferred approach as circumstances change and as they develop a more nuanced understanding of how best to proceed."[46] Consistent with this caselaw, CFPB has the discretion to make judgments about the scope of its rulemakings and to decide to leave certain issues for further proceedings.[47]

The Proposed Rule takes up the Supreme Court's invitation to conduct step-by-step regulation and proceeds in exactly such a manner. CFPB's preliminary determination that it should start with the largest financial institutions in regulating overdraft fees is a well-reasoned, non-arbitrary first step. The Proposed Rule states that adapting to regulatory change would pose specific challenges for small financial institutions.[48] The Proposed Rule explicitly leaves the door open to further regulation, noting that CFPB will continue to monitor the market practices of smaller financial institutions.[49] **CFPB should consider announcing in its Final Rule a timeline to conduct a data collection inquiring into the overdraft credit practices of and consumers served by smaller financial institutions, to further demonstrate its step-by-step approach.**

Notably, Congress itself has set the threshold for CFPB's primary supervisory authority at $10 billion.[50] In doing so, it recognized that very large financial institutions (i.e., those above this asset level) merit particular scrutiny from regulators. CFPB did not arbitrarily choose a $10 billion threshold for the Proposed Rule's scope, but rather built on Congress's *own* determination

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[44] FCC v. Fox Television Stations, Inc., 556 U.S. 502, 522 (2009) ("Nothing prohibits federal agencies from moving in an incremental manner.").
[45] Massachusetts v. E.P.A., 549 U.S. 497, 524 (2007).
[46] *Id.*; *see also* Nat'l Ass'n of Broadcasters v. FCC, 740 F.2d 1190, 1207 (D.C. Cir. 1984) ("In classifying economic activity, agencies . . . need not deal in one fell swoop with the entire breadth of a novel development; instead, 'reform may take place one step at a time, addressing itself to the phase of the problem which seems most acute to the [regulatory] mind.'" (quoting *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955)).
[47] Alon Ref. Krotz Springs, Inc. v. EPA, 936 F.3d 628, 659 (2019) (explaining that administrative agency's "discretion properly includes judgments about the scope of rulemakings and when to relegate ancillary issues to separate proceedings").
[48] Proposed Rule, 89 Fed. Reg. at 13,860.
[49] *Id.*
[50] 12 U.S.C. § 5515(a).

that banks above this threshold were qualitatively different from their smaller peers and sometimes should be regulated differently.[51]

CFPB has offered valid justifications for beginning its approach to regulating overdraft credit with the largest financial institutions. Because consumers are also harmed by overdraft fees imposed by smaller institutions, CFPB should consider how it can most appropriately go further and outline potential next steps. Observing the impacts of the Proposed Rule and using it to inform next steps is a legally justified and well-reasoned approach to doing so.

III. To calculate benchmark fees, CFPB should consider average, rather than high-end, charge-off rates and recognize that the $6 and $14 benchmark options overestimate the breakeven point.

CFPB has set forth four potential benchmark fees, which use two different parameters to estimate a bank's costs per overdraft. First, CFPB calculated total costs based on either (1) the average charge-off rates across the five financial institutions that had provided sufficient data, or (2) the highest reported charge-off rates in its sample.[52] In either case, CFPB considered the total costs among overdrafts, regardless of whether a fee was actually assessed. Second, CFPB calculated the number of overdrafts in the denominator by either: (1) the total number of overdrafts, or (2) the total number of overdrafts *that incurred a fee* (e.g. ignoring overdrafts where the fee was waived).[53] In considering which benchmark methodology to adopt, CFPB should consider average charge-off rates, rather than the highest charge-off rates, and—if CFPB understands banks to be making rational, profit-maximizing decisions in waiving fees—should consider losses only from overdrafts where a fee was charged.

A. CFPB should use average charge-off values to set a benchmark fee.

Several considerations support using average charge-off rates, rather than the highest charge-off rate. First, using average charge-off rates would allow the Proposed Rule to deliver greater distributional benefits to consumers. Second, compliance cost savings and easier administrability from using the higher benchmark are likely limited.

Using the highest charge-off rate to set the benchmark will decrease the consumer benefits from the Proposed Rule. Capping fees is primarily a transfer from banks to consumers, but, as will be discussed in Part V, that transfer reduces the negative effects from a market failure and has positive distributional effects. If CFPB uses the average charge-off rate, banks with breakeven costs less than or equal to the benchmark will rationally choose to charge the benchmark rate. If CFPB uses the highest charge-off rate in its sample to set the benchmark, then very few banks should have a cost greater than the benchmark. This means nearly all banks should be expected to charge the benchmark fee—including banks with actual costs below the benchmark.

The cost-savings to CFPB's administration and oversight of the program and to banking compliance costs from using the higher charge-off rate seem limited. If more banks choose to accept CFPB's default benchmark fee, it may be easier for CFPB to determine if a bank is compliant with the regulation, as compared with the agency needing to review individual calculations of costs and losses. However, only about 175 very large financial institutions are

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[51] *See* Proposed Rule, 89 Fed. Reg. at 13,860.
[52] *Id*. at 13,871.
[53] *Id.*

covered by the Proposed Rule[54] and, assuming a normal distribution, half of them would have breakeven costs at or below the average and would take the benchmark under the average charge-off scenario. The number of entities likely to opt for individual calculations of a breakeven fee is an administratively manageable number. Further, it is not clear that using a higher benchmark would decrease compliance costs for banks; a bank would likely need to calculate its own breakeven costs, regardless, in order to decide whether to use the benchmark fee in the first place.[55] Compliance savings from the higher benchmark therefore seem likely to be low.

CFPB should consider whether the decreased consumer benefits from a higher benchmark fee are outweighed by modest increases in administrability and small decreases in compliance costs.

B. CFPB should consider losses from waived and charged overdrafts separately, meaning the $6 and $14 benchmark fees are too high.

Assuming a bank is offering waivers in a rational, profit-maximizing way, it is dividing overdrafts into two pools: those that receive waivers ("waived overdrafts") and those that do not ("charged overdrafts"). Within a given pool, the breakeven point should be the average net costs to the bank within that pool. **Accordingly, the $6 and $14 fees—which attribute losses from the waived overdraft pool to the charged overdraft pool—would overestimate the breakeven point.**

If a bank is rational, then it will offer a fee waiver on overdraft credit only if the expected benefit to the bank minus the expected costs is greater than or equal to zero. The benefits of waiving a fee could include improved customer relations.[56] It may also be that the bank has determined the risk associated with those accounts is reduced compared to the general overdraft pool, reducing losses.[57] When banks do not charge fees to a group of overdrafts, it is reasonable to infer that the breakeven cost to the bank from those overdrafts is zero.

The breakeven point for charged overdrafts should be less than or equal to the average losses among charged overdrafts (the sum of charge-offs and administrative fees from charged overdrafts divided by the number of charged overdrafts). The reason the breakeven point may be less than the average losses is because, as with waived overdrafts, the bank may be receiving other benefits from the program that balance out the losses. For example, if—as banks say—overdraft is something that customers want and need, a bank might receive benefits from offering overdraft through improved customer acquisition and retention, providing benefits to the bank above and beyond the fees charged.[58] Estimating these benefits would be challenging, but the bottom line is that the breakeven point for a bank for charged overdrafts certainly should not

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[54] Proposed Rule, 89 Fed. Reg. at 13,894.
[55] The proposed fees are constructed from the charge-off losses within a sample of eight financial institutions. A bank may not know if the highest losses, among that sample, is greater or less than its charge-off, so it would still need to calculate its breakeven cost to know whether to accept the benchmark.
[56] Proposed Rule, 89 Fed. Reg. at 13,889.
[57] According to a CFPB survey, banks offer waivers based on the following factors: "(1) age of the account, (2) available balance, (3) account transaction activity and history, (4) standing of the account, and (5) existence of direct deposits," which points towards a rational consideration of risks and benefits from waiver. Proposed Rule, 89 Fed. Reg. at 13,889 & n.243.
[58] *See e.g.* Jeanne Sahadi, *Biden Administration Proposes Rule That Could Save Consumers $3.5 Billion a Year in Bank Fees*, CNN (Jan. 17, 2024), https://www.cnn.com/2024/01/17/success/bank-overdraft-fees-cfpb/index.html.
[58] 15 U.S.C. § 1601(a).

exceed the average losses among charged overdrafts. Accordingly, the $6 and $14 fees overestimate the breakeven point, as they attribute losses from waived overdrafts to the breakeven point of charged overdrafts and fail to account for the benefits to customer retention that banks enjoy from providing overdraft services.

In contrast, if CFPB thinks that financial institutions offer waivers in a non-programmatic or irrational way, losses from the waived pool would be properly considered alongside those from the charged pool. In such a case, however, CFPB should still consider whether and how a bank benefits from its overdraft program.

IV. CFPB should clearly identify relevant market failures and explain how the Proposed Rule will remedy them.

Although the Office of Management and Budget's (OMB) Circular A-4 guidance on regulatory analysis does not directly apply to CFPB as an independent agency, Circular A-4 can be a useful guide to best practices when CFPB considers costs and benefits as required by the Consumer Financial Protection Act (CFPA).[59] According to Circular A-4, "[m]odeling underlying market, institutional, or behavioral distortions is a standard starting point for conducting benefit-cost analysis of a regulatory action" that can help inform a thorough assessment of the need for regulation.[60]

CFPB should make it clear that regulation is needed, and that disclosure alone will not be enough to achieve the purpose of the Proposed Rule because of two market failures in the non-covered overdraft credit market. First, information asymmetry leads consumers to sometimes rely on economically inefficient overdraft transactions. Second, behavioral biases such as overconfidence bias and salience bias contribute to market failure and help explain why the Proposed Rule correctly implements additional regulatory tools, such as the prohibitions on compulsory use of EFTs.[61] CFPB should highlight these various market failures as further justification for the rule.

A. Information asymmetry leads consumers to sometimes engage in economically inefficient overdraft transactions.

CFPB rightly asserts that the Proposed Rule's disclosure requirements are beneficial because they "promot[e] informed use of credit" consistent with the enabling statutes.[62] However, the agency should also clearly state that there is information asymmetry in the current non-covered overdraft system and that it can lead consumers to engage in inefficient overdraft transactions.

The current market has an information asymmetry issue: **VLFIs are aware of how their non-covered overdraft products measure up to other comparable credit products, but consumers often lack this knowledge.**[63] Typical VLFI disclosures about policies that affect

[59] 12 U.S.C. § 5512(b)(2)(A).
[60] OFF. OF MGMT. & BUDGET, CIRCULAR A-4: REGULATORY ANALYSIS 14–15 (2023) [hereinafter CIRCULAR A-4]. Circular A-4 "provides the [OMB's] guidance to Federal agencies on the development of regulatory analysis as required under Section 6(a)(3)(C) of Executive Order 12866 of September 30, 1993." *Id.*
[61] *See* Proposed Rule, 89 Fed. Reg. at 13,854 (discussing compulsory fund transfers).
[62] *Id.* at 13,853.
[63] *See id.* at 13,868–69 ("The fact that frequent overdrafters continue to use non-covered overdraft credit services despite its higher cost relative to other credit suggests that some frequent overdrafters have difficulty comparing non-covered overdraft credit services with available alternatives.").

when a fee might be charged are complex, and "even consumers who closely monitor their account balances may not know with certainty when transactions will post to their accounts, whether a particular transaction will be paid or returned unpaid, and whether a particular paid transaction will be deemed an overdraft and assessed an overdraft fee."[64] Consumers themselves have complained to CFPB that overdraft fees are "unclear or confusing" and "difficult or impossible to avoid."[65] Consequently, customers who use non-covered overdraft credit do not "have all of the necessary information to make an informed decision about the transaction."[66]

CFPB recognizes that requiring Regulation Z disclosure for non-covered overdraft credit above the breakeven standard will help consumers make more informed comparisons in the credit market.[67] CFPB should more expressly justify the Proposed Rule as correcting for the market failure of information asymmetry.[68]

B. The Proposed Rule Will Likely Help Remedy Behavioral Biases Related to Overconfidence and Salience.

CFPB should also recognize that dynamics present in the non-covered overdraft credit market suggest the presence of behavioral biases that justify the Proposed Rule, particularly regulation of fee-levels.[69] **Due to overconfidence bias and lack of salience, disclosure alone is likely insufficient to solve the problem at hand.** Circular A-4 directs agencies to "carefully consider the degree to which the evidence available indicates that behavior reflects fully rational preferences and the degree to which it indicates that such behavior is the product of a behavioral bias observed in, or applicable to, the specific regulatory context."[70] This is one such context.

Patterns identified by CFPB suggest that behavioral biases likely affect consumer reliance on non-covered overdraft credit. Notably, for instance, CFPB research shows that even consumers who have affirmatively "opted-in" to overdraft services on one-time debit card and credit transactions (OTCB) continue to frequently incur large overdraft fees.[71] Specifically, financial institutions may charge overdraft fees on OTCB transactions only after account holders receive

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[64] *Id.*
[65] *Id.* at 13,857.
[66] CIRCULAR A-4, *supra* note 60, at 17.
[67] *See* Proposed Rule, 89 Fed. Reg. at 13,857.
[68] *See* CIRCULAR A-4, *supra* note 60, at 15, 17 (noting that "imperfect or asymmetric information" can "substantially affect" the consumer credit market absent government regulation).
[69] *See* OFF. OF MGMT. & BUDGET, 2009 REPORT TO CONGRESS ON THE BENEFITS AND COSTS OF FEDERAL REGULATIONS AND UNFUNDED MANDATES ON STATE, LOCAL, AND TRIBAL ENTITIES 37 (2009) [hereinafter OMB 2009 REPORT] (explaining that, to be effective, disclosure must be "clear, meaningful, timely, and salient").
[70] CIRCULAR A-4, *supra* note 60, at 18.
[71] Proposed Rule, 89 Fed. Reg. at 13,857 (finding that consumers who opted-in to non-covered overdraft credit "incurred more than seven times as many overdraft fees" than non-opted-in accounts and were 2.5 times as likely to be subject to involuntary account closure). While some customers may overdraft intentionally, having compared available credit products and unaffected by behavioral biases, when surveyed, only 22% of customers charged an overdraft fee in the past year had expected to overdraft. CONSUMER FIN. PROT. BUREAU, OVERDRAFT AND NONSUFFICIENT FUND FEES: INSIGHTS FROM THE MAKING ENDS MEET SURVEY AND CONSUMER CREDIT PANEL 5 (2023), https://files.consumerfinance.gov/f/documents/cfpb_overdraft-nsf-report_2023-12.pdf [hereinafter CFPB MAKING ENDS MEET]. The likelihood a customer expected an overdraft increases with the frequency of overdraft, but even among customers charged more than 10 overdrafts in the past year, only a bit over half of overdrafts were expected. *Id.* at 14. This suggests behavioral biases may be prevalent in most instances.

Regulation E disclosures and affirmatively "opt-in."[72] As CFPB has previously found, "[c]onsumers overdraw their accounts more often via debit card transactions than by any other means."[73] Thus, most overdrafters have already received disclosure. This suggests that for at least some consumers, additional disclosure may not be enough to further CFPB's intended benefit of reducing overdraft fees.

Several behavioral biases could help explain these trends. For one, frequent overdrafters may be exhibiting an overconfidence bias—when opting-in, that is, they incorrectly believe they will not overdraft their accounts and experience later costs.[74] This pattern also suggests that changing the non-covered overdraft credit system default to an opt-in rule—an option generally recommended by the Office of Management and Budget[75] and implemented by CFPB under Regulation E[76]—has not achieved the benefits that CFPB seeks.

The fact that overdraft is often the result of consumer mistake provides further evidence of overconfidence bias.[77] For instance, the Financial Health Network found that only 16 percent of consumers who overdrafted in 2022 knew their balance was insufficient when they overdrafted.[78] Consumers may mistakenly believe they are aware of their account balance and assume they have enough money to cover a transaction, even though this information is often readily available through a mobile financial services app. One particular example of mistake is an "authorize positive/settle negative" transaction, in which an additional "intervening" transaction lowers the account balance between authorization and settlement such that an overdraft fee is charged.[79] When this occurs, even if consumers have confirmed a positive account balance prior

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[72] 12 C.F.R. § 1005.17(b). Financial institutions may charge overdraft fees on check, Automated Clearing House (ACH), and recurring card-based transactions without an affirmative opt-in. *Id.* Though opt-in rates vary across financial institutions, the mean opt-in rate for the first two years after Regulation E was implemented in 2009 was 19.4%. CONSUMER FIN. PROT. BUREAU, *A Closer Look: Overdraft and the Impact of Opting-In* (Jan. 19, 2017), https://files.consumerfinance.gov/f/documents/201701_cfpb_Overdraft-and-Impact-of-Opting-In.pdf [hereinafter CFPB CLOSER LOOK].

[73] CFPB CLOSER LOOK, *supra* note 72, at 3.

[74] Overconfidence bias here refers to "overoptimism," meaning that "individuals overestimate their own abilities or prospects, either in absolute terms or in comparison to others" which "can lead consumers to misforecast their future product usage, or to overestimate their abilities to navigate contract terms," resulting in suboptimal results. *See* Michael D. Grubb, *Overconfident Consumers in the Marketplace*, J. ECON. PERSPS., Fall 2015, at 9–10, https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.29.4.9; *see also* David de Meza et al., *Financial Capability: A Behavioural Economics Perspective*, FIN. SERVS. AUTH. 50 (2008), https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=2328a5bf7f7bebf0596ac2d58d00e6ec7b5f1a00 ("People are too ready to borrow because they are too optimistic about their ability to repay.").

[75] *Cf.* OMB 2009 REPORT, *supra* note 69, at 39 (recommending as a general matter that agencies consider switching default rules from opt-out to opt-in as a low-cost method to achieve regulatory goals).

[76] 12 C.F.R. § 1005.17(b); *see also* Proposed Rule, 89 Fed. Reg. at 13,854 ("For one-time (non-recurring) debit card and ATM transactions, financial institutions may not assess overdraft fees for paying such transactions without first obtaining the consumer's opt-in following the process required by Regulation E.").

[77] *Id.* at 13,891 n.251.

[78] Fin. Health Network, *Overdraft Trends Amid Historic Policy Shifts* (June 1, 2023), https://finhealthnetwork.org/research/overdraft-trends-amid-historic-policy-shifts (explaining that half of those who overdrafted said their most recent overdraft was unintentional, 28% said they knew their balance was low, but the overdraft was "effectively a gamble" and only 16% "knew their balance was insufficient.").

[79] DAVID LOW ET AL., CONSUMER FIN. PROT. BUREAU, DATA POINT: FREQUENT OVERDRAFTERS 29 (2017), https://files.consumerfinance.gov/f/documents/201708_cfpb_data-point_frequent-overdrafters.pdf. CFPB identifies that these transactions "are most likely to occur in accounts that regularly have very low balances and that transact frequently"—account characteristics which are typical of frequent overdrafters. *Id.*

to an OTCB transaction, they might be overconfident that their accounts will close in the positive, and they might be overconfident about their ability to make an informed decision about the order and timing in which future transactions will post.

Salience bias may also contribute to overdrafting.[80] Though consumers receive disclosures at opt-in, this information likely lacks salience.[81] Consumers may not be able to predict when they will incur a fee in part because they misunderstand the complex overdraft fee terms.[82] Additionally, because salience and consumer attention to overdraft fee policies likely declines over time without reminders, consumers might not consider the overdraft fee and its consequences at the point of sale.[83] The evidence of mistake and the later negative consequences of relying on overdraft credit also indicates that consumers may be making myopic decisions; they are overly discounting future effects for the sake of short-term benefits of clearing the transaction.[84]

CFPB suggests that VLFIs might respond to the Proposed Rule by limiting consumer access to non-covered overdraft credit.[85] This could potentially reduce liquidity options, but consumers also would not pay the current high fees or risk involuntary account closure.[86] Though limiting access to non-covered overdraft credit would likely impose some costs on consumers, it could also yield some benefits insofar as overdraft is the result of misinformation, mistake, and behavioral biases rather than intentional, rational choices. In fact, the annual percentage rate (APR) of non-covered overdraft credit tends to be substantially higher than other sources of liquidity like payday loans, suggesting that consumers who choose to take on overdraft credit may often have other lower-cost options available to them.[87]

Additionally, if VLFIs were to offset lost revenue by increasing the cost of consumer checking or lowering the percentage paid to consumers from asset accounts, it would likely not implicate the same behavioral biases. Checking account maintenance fees might be more salient to consumers because they are paid on a regular basis, not at point of sale. To the extent there are behavioral biases at account opening related to maintenance fees, their influence is limited, as compared to overdraft fees, because consumers see these fees on a predictable and regular basis, every month.

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[80] *See* OMB 2009 REPORT, *supra* note 69, at 35–37, 40 (discussing salience bias).
[81] *See* Natasha Sarin, *The Salience Theory of Consumer Financial Regulation*, 17–21 (U. Penn. L. Sch. Inst. L. & Econ., Research Paper No. 18-30, 2018), https://ssrn.com/abstract=3224172.
[82] *See id.* at 18; OMB 2009 REPORT, *supra* note 69, at 37–38.
[83] *See* Trevor Bakker, Eva Nagypál & Colin Watson, Preliminary, *The Dynamics of Overdraft Fees and Incidence*, FED. DEPOSIT INS. CORP. 16–17 (Apr. 22, 2014), https://www.fdic.gov/analysis/cfr/consumer/2014/panel4/bakker.pdf; Victor Stango & Jonathan Zinman, *Limited and Varying Consumer Attention: Evidence from Shocks to the Salience of Bank Overdraft Fees*, 27 REV. FIN. STUD. 990, 1021 (2014).
[84] Myopia involves "intertemporal discounting" in which "there is a natural tendency to discount utility in the distant future more heavily than in utility in nearer time periods." Michael S. Finke & Sandra J. Huston, *Risk and Myopic Financial Decisions*, 3 J. PERSONAL FIN. 99, 100 (2004), https://www.researchgate.net/publication/228917397_Risk_and_Myopic_financial_decisions. Commentators have documented the influence of myopia on decisions that sacrifice long-term financial benefit for short-term gains. *See* Jae Min Lee, Kyoung Tae Kim & Sherman D. Hanna, *The Negative Association Between Myopia and Financial Well-Being as Moderated by Financial Knowledge*, at 15 (Apr. 30, 2022) (accepted in J. Fin. Counseling Plan.) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4097775 (finding that "myopic discounters had a lower level of financial well-being than non-myopic").
[85] Proposed Rule, 89 Fed. Reg. at 13,889–90.
[86] *Id.* at 13,891.
[87] *See id.* at 13,868, 13,868 n.166.

Accordingly, CFPB should emphasize that behavioral patterns observed in the non-covered overdraft credit market support the Proposed Rule.

V. CFPB should explain that distributional effects further justify the Proposed Rule.

CFPB conducts an extensive analysis of the Proposed Rule's impacts on banks and customers. But it diminishes the effect of that analysis by misleadingly stating that costs and benefits to VLFIs "mostly mirror the existence and extent of each respective pecuniary benefit or cost to their customers."[88] This statement masks the rule's distributional benefits in two ways. First, low-income consumers who are more likely to incur overdraft fees may face undesirable "knock-on" effects, such as account closure or negative screening reports; avoiding these knock-on effects is not a transfer, but rather a true benefit of the Proposed Rule. Second, because of the diminishing marginal utility of income, the benefit to the low-income households of paying lower fees is likely greater than the benefits that shareholders of VLFIs would receive from banks having collected these fees. Thus, **reducing overdraft fees is not simply a "mirror"-image transfer of costs and benefits between banks and customers, but rather delivers net benefits to customers and particularly to low-income customers**.

Additionally, CFPB should further explain that the Proposed Rule may help remedy what is likely a regressive cross-subsidization of consumer checking, where overdraft fees from the least-resourced customers are subsidizing cheaper checking products for the remaining customers.[89] CFPB should clearly state these points to address concerns that VLFIs may raise fees elsewhere to balance reductions in overdraft fees.[90]

As an initial matter, it is consistent with CFPB's enabling statutes to consider distributional concerns. Both CFPA and TILA were designed to promote fairness in the markets for financial products and direct CFPB to protect consumers from unfair and deceptive practices.[91] These purpose statements suggest that Congress intended for CFPB to regulate to promote fairness and transparency. And as further discussed below, current practices in the non-covered overdraft credit market tend to harm low-income customers, who often shoulder the burden of regressive cross-subsidization. And as discussed above, these conditions are likely in part the result of inadequate disclosure practices—the very problem that the enabling statutes are meant to solve.[92]

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[88] *Id.* at 13,894.

[89] The Proposed Rule explains that VLFIs currently collect over $6 billion in overdraft fees, annually. Proposed Rule, 89 Fed. Reg. at 13,856. Across the banking sector, overdraft fees and non-sufficient fund (NSF) fees account for about two-thirds of fee revenue from checking accounts. *CFPB Research Shows Banks' Deep Dependence on Overdraft Fees*, CFPB (Dec. 1, 2021), https://www.consumerfinance.gov/about-us/newsroom/cfpb-research-shows-banks-deep-dependence-on-overdraft-fees/. Overdraft and NSF fees disproportionally affect low-balance customers, who tend to be lower income.

[90] *See, e.g.*, Stuart Richter, Eric Hail & Eric Werlinger, *CFPB Overdraft Rule Could Mean Big Shift In Banking Biz*, LAW360 (Feb. 16, 2024), https://www.law360.com/articles/1795343?e_id=5cde651e-7c5d-483f-b839-122fd4c09d19&utm_source=engagement-alerts&utm_medium=email&utm_campaign=similar_articles&detected=1; Megan McArdle, *Capping Overdraft Fees Could Actually Hurt Poor Families*, WASH. POST (Jan. 24, 2024), https://www.washingtonpost.com/opinions/2024/01/24/cap-overdraft-fees-hurt-poor-families.

[91] *See* 12 U.S.C. § 5511(a) (directing CFPB to ensure that "markets for financial products are *fair*, transparent, and competitive" (emphasis added)); 12 U.S.C. § 5511(b)(2) (authorizing CFPB to regulate to protect consumers "from *unfair*, deceptive, or abusive acts and practices" (emphasis added)); 15 U.S.C. § 1601 (articulating a purpose to "protect the consumer against inaccurate and *unfair* credit billing and credit card practices" (emphasis added)).

[92] In the CFPA, Congress also directed CFPB to monitor whether "the risks of a consumer financial product or service may disproportionately affect *traditionally underserved consumers*," 12 U.S.C. § 5512(c)(2)(E) (emphasis

Thus, CFPB can and should bolster its arguments in support of the Proposed Rule by explaining that because frequent overdrafters are likely to be low-income, transfer of benefits to these consumers is likely to be more than a zero-sum transfer.

A. Low-income consumers are more likely to incur overdraft fees and experience additional harms from those overdrafts, and the resulting transfer to these consumers represents a distributional benefit.

CFPB notes that the benefits of reduced fees from the Proposed Rule will be "predominantly experienced by the small fraction of accountholders who had either opted-in accounts or lower-balance accounts because those accountholders paid the majority of overdraft fees."[93] Importantly, these accountholders are more likely to be lower income.[94]

While this information on the rule's distributional impacts offers a useful starting point, CFPB should more expressly make a "connection between the distributional interest being pursued and the analysis of the regulation."[95] In particular, CFPB should make two points to show that the Proposed Rule's benefits to consumers are greater than the dollar value of reduced overdraft fees. First, because frequent overdrafters are often low-income and financially insecure, negative effects often follow from overdraft fees that impose additional costs. Second, overdraft fee revenue transferred from VLFIs to the beneficiaries of the Proposed Rule is not a zero-sum transfer when considering the diminishing marginal utility of income.[96]

High non-covered overdraft fees can impose costs on consumers beyond the direct fee because they can "make it more difficult for consumers to return their account to a positive balance."[97] This difficulty can contribute to consumers being blocked out of the banking system, as involuntary account closures can result in negative account screening reports that make it difficult to open another account and diminish consumer interest in doing so.[98] CFPB also notes that "[c]onsumers with low balances may deplete their asset account less frequently if they have paid less in overdraft fees in the past, and thus their asset account recovered to a higher balance after a sufficiently large deposit."[99] These knock-on effects can have severe consequences for low-income consumers who are most likely to pay overdraft fees. **Thus, the Proposed Rule will**

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added), and the CARD Act required CFPB to report to Congress on whether existing credit practices "have an adverse impact on minority or low-income customers." Pub. L. 111-24 § 505(b)(2), 123 Stat. 1734, 1757 (2009) (emphasis added); *see also* 15 U.S.C. §1693b(a)(2) (When promulgating regulations under the EFTA, CFPB must prepare an economic impact analysis that considers, among other things, "the availability of [electronic banking] services to different classes of consumers, *particularly low income consumers.*"). These directives by Congress are consistent with an understanding of the enabling statutes that places equity and fairness front of mind.

[93] Proposed Rule, 89 Fed. Reg. at 13,889.

[94] *Id.* at 13,857, 13,889 (citing Oz Shy & Joanna Stavins, *Who Is Paying All These Fees? An Empirical Analysis of Bank Account and Credit Card Fees* (Fed. Rsrv. Bank of Bos., Working Paper No. 22-18, 2022), https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/2022/wp2218.pdf).

[95] CIRCULAR A-4, *supra* note 60, at 62. *See also id* ("The question of who will ultimately experience the benefits and bear the costs of any regulation warrants close attention in a distributional analysis.").

[96] *See id.* at 65–66.

[97] Proposed Rule, 89 Fed. Reg. at 13,857.

[98] *Id.* CFPB considers a study on the effects of lifting overdraft fee caps on the number of consumers with bank accounts but concludes that the study has little bearing on the situation presented by the Proposed Rule. *Id.* at 13,890.

[99] *Id.* at 13,892.

create additional benefits by helping to prevent consumers from becoming trapped in a financial debt spiral.

CFPB points out that the direct savings resulting from application of the benchmark fee will be especially valuable for low-balance consumers because a reduction in fees would contribute to higher account balances and the "shadow line" of their non-covered overdraft credit would not be used up as quickly.[100] The resultant increased liquidity for low-balance consumers would, in turn, permit more consumption.[101] But a reduction in overdraft fees for low-income customers is highly valuable for a more fundamental reason too. Namely, **CFPB should recognize the value of a dollar is greater for low-income individuals due to the diminishing marginal utility of income.**[102] Recognizing this phenomenon will produce a more informed presentation of the Proposed Rule's benefits and costs because the value of a dollar is likely greater to the beneficiaries than for those bearing the costs (indirectly, the shareholders of VLFIs).[103] In other words, the rule likely improves net welfare even though its primarily regulatory effect is a transfer.

This conclusion is not diminished by the potential that, in response to the Proposed Rule, VLFIs may choose to limit the availability of non-covered overdraft credit for the types of consumers who rely on it most.[104] This is because, depending on the size of the overdraft, even a payday loan may be a better alternative for consumers than non-covered overdraft credit. CFPB calculations show that the annual percentage rate (APR) for the typical payday loan is 391 percent, whereas the APR for non-covered overdraft credit is much higher—a staggering 16,000 percent.[105] Viewed in this context, reduced access to non-covered overdraft credit might be a *benefit* to consumers, even for those who intentionally overdraft, especially considering the information asymmetry and behavioral biases discussed above.[106] Thus, CFPB should make clear that potential loss of access to non-covered overdraft credit does not necessarily negate the distributional benefits to low-income consumers.

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[100] *Id.*
[101] *Id.*
[102] *See* CIRCULAR A-4, *supra* note 60, at 65–66.
[103] *See id*.
[104] Proposed Rule, 89 Fed. Reg. at 13,857 (noting that consumers who frequently overdraw are less likely to have credit cards, and if they do have credit cards, they likely have low credit limits, and that they might not have other available funds to transfer to the overdrawn account); *but see* CFPB MAKING ENDS MEET, supra note 71, at 30–31 (explaining that a majority of households who overdraft report having credit on a credit card—a less expensive form of credit than a payday loan or overdraft credit—in the same period the overdraft occurred, suggesting that, for at least some customers, overdrafting was unnecessary).
[105] *Id.* at 13,868, 13,868 n.166. This calculation is based on CFPB research from 2022–2023 finding that the typical overdraft fee was $35, the median size of overdraft extension was $25.50, and "the majority of non-covered overdraft credit transactions were repaid in three days." *Id.* CFPB uses 17,000 as its APR figure in the Proposed Rule based on data from 2014, which is consistent with these more recent numbers. *Id. See also* CFPB, *What is a Payday Loan*? (last updated Jan. 17, 2022), https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/ (explaining that many states regulate payday lending fees at between $10 and $30 in biweekly fees per $100 in credit). The comparison to payday lending rates does, of course, vary when considering larger overdrafts. *See* Brian Melzer & Donald Morgan, *Competition and Adverse Selection in the Small-Dollar Loan Market: Overdraft versus Payday Credit*, (Staff Rpt. No. 391, Fed. Reserve Bank of New York) (Sept. 2009), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr391.pdf.
[106] *See id.* at 13,890–91, 13,891 n.251.

The transfer resulting from the Proposed Rule would not be a net-zero transfer. Rather, because frequent overdrafters are typically low-income and financially insecure, the Proposed Rule will have positive impacts beyond the dollar amount of the overdraft fee, likely resulting in positive net benefits. CFPB should draw out these arguments to bolster its reasoning.

B. CFPB should further explain that the Proposed Rule may help remedy regressive cross-subsidization of consumer checking.

CFPB notes that total consumer gains will be reduced if the VLFIs increase checking account fees or lower deposit account interest rates in response to the Proposed Rule.[107] Though CFPB correctly argues that the Proposed Rule would "redistribute the burden of paying for consumer checking services in the United States,"[108] CFPB should also recognize that this would not be a zero-sum transfer because it will likely help remedy regressive cross-subsidization of consumer checking services.

Circular A-4 advises that "it is often important to assess and present the distribution of conditions in the baseline, in addition to the distribution of regulatory effects" because a policy "may in fact be remedying inequitable conditions that [already] exist."[109] Frequent overdrafters, who are typically financially insecure and low-income, are essentially subsidizing consumers of financial checking services in general.[110] The Proposed Rule would likely help correct this baseline inequity by transferring the burden in a way likely to spread costs across a larger segment of the consumer population with a more average overall level of income, thereby mitigating regressive cross-subsidization.[111] CFPB should explicitly make this connection.

In short, CFPB should explicitly acknowledge that because beneficiaries of the Proposed Rule will largely be low-income consumers, potentially increased consumer checking fees will not be an equally offsetting cost. Rather, the transfer will likely have a net welfare benefit because it will help remedy the baseline inequity of regressive cross-subsidization.

<u>Conclusion</u>

The Proposed Rule is a commendable approach to mitigating the harms to consumers from reliance on non-covered overdraft credit. However, CFPB should bolster its support for the rule by: (1) expanding upon its statutory authority; (2) further supporting its reasons for changing policy; (3) explicitly acknowledging the market failures that the Proposed Rule is intended to address, and how it will help remedy them; and (4) emphasizing its analysis of distributional effects analysis to ensure a full presentation of regulatory benefits. In addition, CFPB should use

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[107] *Id.* at 13,893.
[108] *Id.*
[109] *See* CIRCULAR A-4, *supra* note 60, at 62.
[110] *See* Proposed Rule, 89 Fed. Reg. at 13,857, 13,889; *see* Grubb, *supra* note 74, at 29–30.
[111] It is possible that replacement fees may also be regressive, for example, some checking accounts waive fees for consumers who comply with certain conditions, sometimes involving maintaining a minimum balance. *See, e.g.*, Emily Sherman, *Checking Account Fees: How Much They Are and How to Avoid Them*, FORBES (Nov. 1, 2023, 11:06 AM), https://www.forbes.com/advisor/banking/checking/fees-for-checking-accounts. Nonetheless, as CFPB notes, it is unlikely that other types of account fees—such as maintenance fees—are as concentrated as overdraft fees. Proposed Rule, 89 Fed. Reg. at 13,893. A mere 5% of accounts pay 63% of overdraft and NSF fees. *Id.* at 13,857.

average charge-off rates and recognize that the $6 and $14 benchmarks would be overestimates of breakeven losses from charged and waived overdrafts separately.

Respectfully,

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