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CFPB GUIDANCE – AVOIDING CHARGING ILLEGAL “JUNK FEES” ON DEPOSIT ACCOUNTS

I. INTRODUCTION

The Consumer Financial Protection Bureau (CFPB) recently issued guidance about two “junk fee” practices that are likely unfair and unlawful under existing law. The first, surprise overdraft fees, includes overdraft fees charged when consumers had enough money in their account to cover a debit charge at the time the bank authorizes it. The second is the practice of indiscriminately charging depositor fees to every person who deposits a check that bounces.

The CFPB Indicates that overdraft and depositor fees likely violate the Consumer Financial Protection Act (CFPA) prohibition on unfair practices when consumers cannot reasonably avoid them. The Consumer Financial Protection Circular 2022-06 (https://files.consumerfinance.gov/f/documents/cfpb_unanticipated-overdraft-fee-assessment-practices_circular_2022-10.pdf) on surprise overdraft fees and the CFPB’s Bulletin 2022-06 (https://files.consumerfinance.gov/f/documents/cfpb_returned-deposited-item-fee-assessment-practice_compliance-bulletin_2022-10.pdf) layout when a financial institution’s back-end penalties likely break the law.

II. SURPRISE DEPOSITOR FEES – UNFAIR RETURNED DEPOSIT ITEM FEE ASSESSMENT PRACTICES

A. Returned Deposit Items

A Returned Deposited Item is a check that a consumer deposits into their checking account that is returned to the consumer because the check could not be processed against the check originator’s account. Blanket policies of charging Returned Deposited Item fees to consumers for all returned transactions irrespective of the circumstances or patterns of behavior on the account are likely unfair under the CFPA. The CFPB has issued its bulletin to notify regulated entities how it intends to exercise its enforcement and supervisory authorities on this issue.

There are many reasons deposited items can be returned unprocessed. For example, the check originator may not have sufficient funds available in their account to pay the

amount stated on the check; the check originator may have directed the issuing depository institution to stop payment; the account referenced on the check may be closed or located in a foreign country; or there may be questionable, erroneous, or missing information on the check, including with respect to the signature, date, account number, or payee name.

In many circumstances, the check depositor has no control over whether, and likely no reason to anticipate that, the deposited check would be returned. Nor as a general matter can the check depositor verify with the check originator's depository institution prior to depositing a check whether there are sufficient funds in the issuer's account for the check to clear. Yet, many depository institutions have blanket policies of charging fees to the check depositor for Returned Deposited Items for every Returned Deposited Item, irrespective of the circumstances of the particular transaction or patterns of behavior on the account.

B. Violations of CFPA

The Consumer Financial Protection Act (CFPA) prohibits covered persons from engaging in unfair acts or practices. Congress defined an unfair act or practice as one that (A) "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable," and (B) "such substantial injury is not outweighed by countervailing benefits to consumers or to competition."

Blanket policies of charging Returned Deposited Item fees to consumers for all returned transactions irrespective of the circumstances of the transaction or patterns of behavior on the account are likely unfair.

Fees charged for Returned Deposited Items cause substantial injury to consumers. Under the blanket policies of many depository institutions, Returned Deposited Item fees cause monetary injury, in the range of \$10-19 for each returned item. Depository institutions that charge Returned Deposited Item fees for returned checks impose concrete monetary harm on a large number of customers.

In many of the instances in which Returned Deposited Item fees are charged, consumers would not be able to reasonably avoid the substantial monetary injury imposed by the fees. An injury is not reasonably avoidable unless consumers are fully informed of the risk and have practical means to avoid it.

Under blanket policies of many depository institutions, Returned Deposited Item fees are charged whenever a check is returned because the check originator has insufficient available funds in their account, the check originator instructs the originating depository institution to stop payment, or the check is written against a closed account. But a consumer depositing a check would normally be unaware of and have little to no control over whether a check originator has funds in their account, will issue a stop payment instruction, or has closed the account. Nor would a consumer normally be able to verify whether a check will clear with the check originator's depository institution before depositing the check or be able to pass along the cost of the fee to the check originator.

Liability under the prohibition on unfair acts or practices depends on the particular facts and circumstances. The CFPB notes that it is unlikely that an institution will violate the prohibition if the method in which fees imposed are tailored to only charge consumers who could reasonably avoid the injury. **For example, if a depository institution only charges consumers a fee if they repeatedly deposit bad checks from the same originator, or only charges consumers a fee when checks are unsigned, those fees would likely be reasonably avoidable.**

Regulation DD, which applies in relevant part to depository institutions except for credit unions, requires depository institutions to disclose fee information on depository accounts to consumers before an account is opened or a service is provided. The returned item fee is among the fees required to be disclosed in the fee schedule when the consumer first opens the account.

In applying the CFPB's unfairness prohibition, the CFPB cites a court decision and the Federal Trade Commission (FTC) "Credit Practice Rule" to support a finding of "unfairness," even when creditor remedies are disclosed and agreed upon, the FTC determined, since the provisions were not reasonably avoidable because "(1) consumers are not, as a practical matter, able to shop and bargain over alternative remedial provisions; and (2) default is ordinarily the product of forces beyond a debtor's control." The CFPB notes that similar unfairness principles likely apply to account opening disclosures of blanket policies of imposing fees for Returned Deposited Items because, similarly, consumers have limited ability to bargain over specific fee terms in selecting deposit accounts, and consumers are charged these fees in circumstances beyond their control.

The CFPB advises institutions that it may be difficult to show that the injury from blanket policies of charging Returned Deposited Item fees is outweighed by countervailing benefits to consumers or competition. Check processing is a service made broadly available to all depositors of checks, and there is no separate benefit to consumers from having a deposited check returned, as opposed to paid.

Returned Deposited Item fees are also not well-tailored to recoup costs from the consumers actually responsible for the costs to depository institutions of expected losses for the limited circumstances in which the institution cannot recoup funds made available to the depositor on a check that is later returned. Instead, the fee is charged to depositors even where the depository institution incurs no such loss from the returned transaction, and institutions usually do not collect the fee in those limited circumstances where they actually incur a loss (entities only incur a loss because they cannot collect).

Deterring consumers from depositing checks in instances where the checks will be returned may benefit consumers and the public interest if the institution's policy and practice are well-tailored to address the issue, do not harm consumers in some other way, minimize losses to the depository institution that would be passed through to consumers, bolster the integrity of the banking system through loss avoidance, and, in the case of fraud, prevent conduct that offends public policy as embodied in statutes and common

law. However, deterrence can only be accomplished through the collection of fees in circumstances where the consumer anticipates that a check will be returned but deposits it anyway, such as where a consumer knowingly deposits a counterfeit check.

III. SURPRISE OVERDRAFT FEES-UNANTICIPATED OVERDRAFT FEE ASSESSMENT PRACTICES

An overdraft fee can become a surprise fee when the customer doesn't reasonably expect their actions to incur an overdraft fee. For instance, even if a person closely monitors their account balances and carefully manages their spending to avoid overdraft fees, they can easily incur penalties when financial institutions employ processes that are unintelligible or manipulative.

Circular 2022-06 explains that when financial institutions charge surprise overdraft fees, sometimes as much as \$36, they may be breaking the law. The circular provides some examples of potentially unlawful surprise overdraft fees, including charging penalties on purchases made with a positive balance. These overdraft fees occur when a bank displays that a customer has sufficient available funds to complete a debit card purchase at the time of the transaction, but the consumer is later charged an overdraft fee.

A. Authorize Positive, Settle Negative Transactions

In its analysis of surprise overdraft fees the CFPB posed the following:

1. Question Presented

Can the assessment of overdraft fees constitute an unfair act or practice under the Consumer Financial Protection Act (CFPA), even if the entity complies with the Truth in Lending Act (TILA) and Regulation Z, and the Electronic Fund Transfer Act (EFTA) and Regulation E?

2. Response

Yes. Overdraft fee practices must comply with TILA, EFTA, Regulation Z, Regulation E, and the prohibition against unfair, deceptive, and abusive acts or practices in Section 1036 of the CFPA. In particular, overdraft fees assessed by financial institutions on transactions that a consumer would not reasonably anticipate are likely unfair. These unanticipated overdraft fees are likely to impose substantial injury on consumers that they cannot reasonably avoid and that is not outweighed by countervailing benefits to consumers or competition.

As detailed in this Circular, unanticipated overdraft fees may arise in a variety of circumstances. For example, financial institutions risk charging overdraft fees that consumers would not reasonably anticipate when the transaction incurs a fee even though the account had a sufficient available balance at the time the financial institution authorized the payment (sometimes referred to as "authorize positive, settle negative") (APSN).

B. Violations of the Consumer Financial Protection Act

The CFPA prohibits conduct that constitutes an unfair act or practice. An act or practice is unfair when: (1) It causes or is likely to cause substantial injury to consumers that is not reasonably avoidable by consumers; and (2) The injury is not outweighed by countervailing benefits to consumers or to competition.

An unanticipated overdraft fee occurs when financial institutions assess overdraft fees on transactions that a consumer would not reasonably expect would give rise to such fees. Though financial institutions may provide disclosures related to their transaction processing and overdraft assessment policies, these processes are extraordinarily complex, and evidence strongly suggests that, despite such disclosures, consumers face significant uncertainty about when transactions will be posted to their account and whether or not they will incur overdraft fees.

For example, even when the available balance on a consumer's account—that is, the balance that, at the time the consumer initiates the transaction, would be displayed as available to the consumer—is sufficient to cover a debit card transaction at the time the consumer initiates it, the balance on the account may not be sufficient to cover it at the time the debit settles. Since consumers can easily access their available balance via mobile application, online, at an ATM, or by phone, they reasonably may not expect to incur an overdraft fee on a debit card transaction when their balance showed there were sufficient available funds in the account to pay the transaction at the time they initiated it. Such transactions, which the industry commonly calls “authorize positive, settle negative” or APSN transactions, thus can give rise to unanticipated overdraft fees.

The Circular highlights potentially unlawful patterns of financial institution practices regarding unanticipated overdraft fees and provides some examples of practices that might trigger liability under the CFPA. A “substantial injury” typically takes the form of monetary harm, such as fees or costs paid by consumers because of the unfair act or practice. In addition, actual injury is not required; a significant risk of concrete harm is sufficient. An injury is not reasonably avoidable by consumers when consumers cannot make informed decisions or take action to avoid that injury. Injury that occurs without a consumer's knowledge or consent, when consumers cannot reasonably anticipate the injury, or when there is no way to avoid the injury even if anticipated, is not reasonably avoidable. Finally, an act or practice is not unfair if the injury it causes or is likely to cause is outweighed by its consumer or competitive benefits.

Charging an unanticipated overdraft fee may generally be an unfair act or practice. Depending on the circumstances of the fee, such as when intervening transactions settle against the account or how the financial institution orders the transactions at the end of the banking day, consumers could be assessed more than one such fee, further exacerbating the injury. These overdraft fees are particularly harmful for consumers, as consumers likely cannot reasonably anticipate them and thus plan for them.

As a general matter, a consumer cannot reasonably avoid unanticipated overdraft fees, which by definition are assessed on transactions that a consumer would not reasonably

anticipate would give rise to such fees. Mobile banking and the widespread use of debit card transactions could create a consumer expectation that account balances can be closely monitored. Consumers who make use of these tools may reasonably think that the balance shown in their mobile banking app, online, by telephone, or at an ATM, for example, accurately reflects the balance that they have available to conduct a transaction and, therefore, that conducting the transaction will not result in being assessed one or more overdraft fees. But unanticipated overdraft fees are caused by often convoluted settlement processes of financial institutions that occur after the consumer enters into the transaction, the intricacies of which are explained only in fine print, if at all.

The injury from unanticipated overdraft fees likely is not outweighed by countervailing benefits to consumers or competition. Where a financial institution has authorized a debit card transaction, the institution is obligated to pay the transaction, irrespective of whether an overdraft fee is assessed. Access to overdraft programs, therefore, is not a countervailing benefit to the assessment of overdraft fees in such unanticipated circumstances.

C. Examples of Potential Unfair Acts That Consumers Would Not Reasonably Anticipate

The CFPB provides specific examples in Circular 2022-06, on pages 8-12, of potential unfair acts or practices involving overdraft fees that consumers would not reasonably anticipate.

The foregoing Compliance Update is for informational purposes only and does not constitute legal advice. As a reminder, the NBA general counsel is the attorney for the Nebraska Bankers Association, not its member banks. The general counsel is available to assist members with finding resources to help answer their questions. However, for specific legal advice about specific situations, members must consult and retain their own attorney.