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CFPB Issues Notice of Proposed Rulemaking on Credit Card Late Fees

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On February 1, 2023, the Consumer Financial Protection Bureau announced a notice of proposed rulemaking to amend the provisions in Regulation Z governing credit card late fee charges permitted under Regulation Z,[1] which implements the Truth in Lending Act (TILA).[2] Specifically, the CFPB indicated that the proposed rule would:

1. Adjust the safe harbor dollar amount for late fees to $8 and eliminate a higher safe harbor dollar amount for late fees for subsequent violations of the same type.
2. Limit a credit card issuer's ability to implement annual inflation adjustments for the safe harbor dollar amounts in connection with the late fee safe harbor amount.
3. Require that late fee amounts not exceed 25% of the required minimum payment.

According to the CFPB and remarks issued by Director Rohit Chopra, the CFPB professes that the proposed rule would better ensure that credit card penalty fees are "reasonable and proportional" to the late payment as required under TILA and would "ensure that the credit card market is fair and competitive." Chopra also indicated that the CFPB projects that the proposed rule would "reduce credit card late fees paid by Americans by $9 billion each year." Significantly, the proposed rule was immediately endorsed by the White House as a key part of the Biden-Harris administration as one that will "slash excessive credit card fees."

The CFPB is requesting public comment on several aspects of the proposed rule, including the $8 safe harbor provision and whether the safe harbor provision should be eliminated altogether, the ban on automatic inflation adjustment for late fee amounts, the proposed capped late fee percentage, whether the proposed changes should be applied to all credit card penalty fees, whether consumers should be granted a courtesy period before late fees can be assessed, and whether issuers should be required to offer autopay in order to make use of the safe harbor provision. Interested parties may submit comments to the proposed rule through the Federal eRulemaking Portal, by email or via direct mail. **Comments on the proposed rule should be submitted on or before April 3, 2023.**

Background

In May 2009, the Credit Card Accountability Responsibility and Disclosure (CARD) Act was signed into law, and it primarily amended TILA and instituted new substantive and disclosure requirements to establish fair and transparent practices for open-end consumer credit plans (i.e., credit cards). The Credit CARD Act, in part, required penalty fees to be "reasonable and proportional" to the applicable omission or violation. At the time, the Federal Reserve Board of Governors was responsible for promulgating rules to implement the Credit CARD Act and issued a final rule on June 29, 2010, as part of Regulation Z. The final rule included a safe harbor provision for credit card penalty fee amounts and enabled annual fee increases for inflation.

Drawing on data from a March 2022 report, the CFPB suggested that penalty fees have increased over time, surging to as much as $41 for a missed payment in recent years. The CFPB further indicated that such penalties amount to $12 billion per year in late fees, and it has estimated that $9 billion of those late fees are not associated with collection costs that companies incur for late payment violations. Given the issues raised by the report, on June 22, 2022, the CFPB issued an advance notice of proposed rulemaking seeking information from credit card issuers, consumer groups and the public regarding credit card late fees and late payments, and card issuers' revenue and expenses.

In light of the CFPB's research report and advance notice of proposed rulemaking, on February 1, 2023, the CFPB announced its notice of proposed rulemaking to address such penalty and late fees.

The proposed rule

The CFPB invites comments on several aspects of the proposed rule, as outlined below.

Lowering safe harbor dollar amount for late fees from up to $41 to $8

Currently, under Regulation Z and its commentary, a card issuer may not impose a penalty fee for violating the terms of a credit card account (e.g., late fees, over-the-limit fees and insufficient funds fees) unless the issuer has determined that the amount of the fee is a reasonable proportion of the total costs incurred by the issuer for that type of violation or complies with a safe harbor provision. According to Regulation Z, the safe harbor for credit card issuers to impose such penalty fees is $30 for the first violation and $41 thereafter for a violation of the same type. Card issuers may charge these fees without running afoul of the "reasonable and proportionate" fee requirement set forth in TILA.

The proposed rule would lower this safe harbor provision threshold solely for late payment fees from up to $41 to $8 for initial and all other subsequent violations. The CFPB preliminarily found that card issuers generate late fee income exceeding associated collection costs by a factor of five. Because the safe harbor provision currently allows issuers to charge late fees of up to $41, the CFPB indicated that it believes that a late fee of $8 would be sufficient for most issuers to cover collection costs incurred as a result of late payments. However, the CFPB also noted in the proposed rule that several industry trade groups have asserted that although the current $41 safe harbor amount does not cover all the costs associated with late payments and is not as effective a deterrent as higher fees would be, the amount covers a significant portion of issuer costs and deters late payments.

The proposed rule would allow card issuers to charge above the $8 safe harbor as long as they can prove that the higher fee is necessary to cover their incurred collection costs. Further, irrespective of the safe harbor provisions, card issuers still may charge 3% of the delinquent balance on a charge card account that requires payment of outstanding balances under Regulation Z. Under the proposed rule, if finalized, card issuers still would be able to charge for other penalty fees, such as over-the-limit and returned payment fees.

Eliminating automatic annual inflation adjustment

The CFPB's proposal would eliminate the automatic annual inflation adjustment for the safe harbor amount. According to the CFPB, this adjustment is not required by law, nor is it necessarily reflective of how collection costs change over time. The CFPB instead would monitor market conditions and the safe harbor provision amount for potential adjustments as necessary.

Banning late fees in excess of 25% of required minimum payment

Currently, Regulation Z allows a card issuer to potentially charge a late fee that is 100% of the required minimum payment owed by the cardholder. The proposed rule would restrict any late fee charge to 25% of the required minimum payment. This change would only affect late payment fees and would not necessarily apply to all penalty fees that a card issuer may impose for violating the terms of a credit card account.

Further, the 25% cap would apply even if the safe harbor provision would otherwise permit a higher late fee. In other words, if 25% of the minimum payment would equate to less than $8, the card issuer would only be able to charge 25% of the minimum payment despite the card issuer being able to charge an $8 late payment fee under the safe harbor.

Other requests for comment

In the proposed rule, the CFPB also requests comment on the following elements.

Applicability to other penalty fees

As written, the proposed rule only applies to late fees, although the current applicable fee-related provisions of Regulation Z apply to all penalty fees for violation of credit card terms. The CFPB is requesting comment on whether it should expand the rule to apply to other penalty fees outside of late or missed payment fees.

Effective date

In the proposed rule, the CFPB indicates that the final rule, if adopted, would take effect 60 days after publication in the Federal Register. The CFPB is requesting comment on whether it should extend this effective date and when compliance with the proposed changes should be mandatory. The CFPB further requests comment on whether an October 1 effective date mandated by TILA section 105(d) in connection with disclosure-related

changes should be applicable to certain of the proposed changes. Specifically, the CFPB states the following in the proposed rule:

"Separately, under TILA section 105(d), Bureau regulations requiring any disclosure which differs from disclosures previously required by part A, part D, or part E shall have an effective date of October 1 which follows by at least six months the date of promulgation subject to certain exceptions.

To the extent that TILA section 105(d) may apply to any proposed changes requiring disclosures, it would not necessitate the October 1 effective date for purposes of the late fee disclosure for two reasons. First, under Regulation Z, card issuers are currently required to disclose the late fees amounts, or maximum late fees amounts, as applicable, that apply to credit card accounts in certain disclosures, and the disclosure of those late fee amounts must reflect the terms of the legal obligation between the parties. In other words, this proposal, if finalized, would not differ from the current requirement to disclose late fee amounts; instead, it would solely result in a change to the amount of the late fee disclosed for issuers using the safe harbor. Second, this change in amount applies to the safe harbor, which is an amount that card issuers may elect but are not required to use. If the Bureau were to finalize the 15-day courtesy period on which the Bureau solicits comments as discussed in the section-by-section analysis of § 1026.52(b)(2)(i), consistent with TILA section 105(d), the Bureau solicits comment as to whether that courtesy period and potential disclosure language should have an effective date of 'October 1 which follows by at least six months the date of promulgation.'"

Courtesy period requirement

While many card issuers currently provide consumers with a chance to avoid interest and late fees for a period of time after the disclosed due date, Regulation Z does not require card issuers to do so. In public comments to the advance notice of proposed rulemaking, the CFPB received comments from consumer group commenters indicating that the CFPB should prohibit the assessment of a late fee without first providing consumers a period of time after each due date to make the required payment (i.e., a courtesy period). Taking these comments into consideration, the CFPB is asking for comments on whether to require a 15-day courtesy period as part of the final rule and whether the length of this proposed courtesy period is sufficient.

Autopay requirement

In addition to general comments on the $8 safe harbor provision, the CFPB also seeks comment on whether, as a condition of using the safe harbor for late fees, it would be appropriate to require card issuers to offer automatic payment options (such as for the minimum payment amount), or to provide notification of the payment due date within a certain number of days prior to the due date, or both.

Cost analysis

While primarily addressing late payment fees, the rulemaking also clarifies that with respect to all penalty fees, the cost analysis for determining whether a fee is reasonable should not include any collection costs that are incurred after an account is charged off pursuant to loan loss provisions.

Smaller issuers

The proposed rule also requests comment on whether the safe harbor amount may need to be adjusted for smaller issuers. Specifically, the CFPB solicits comments on whether the collection costs for smaller issuers may differ from the costs to larger issuers and, if so, how.

Looking forward

In addition to the CFPB's inquiry into late payment fees, there has been general increased attention on credit card transactions and disclosures. For instance, the Credit Card Competition Act of 2022 was introduced in July 2022 by the Senate and later in September 2022 by the House of Representatives that proposed to expand the multiple payment network routing requirements that currently apply to debit cards to credit cards for issuers with assets of more than $100 billion. Additionally, the bill proposed to prohibit credit card issuers from imposing certain limitations on the routing of electronic credit transactions, such as through penalties for failure to meet a specified threshold of transactions on a particular payment card network. While the bill has not been passed by either chamber of Congress, its introduction signals that Congress is paying closer attention to credit card transactions generally.

The proposed rulemaking is an extension of the ongoing supervisory and examination emphasis on "junk fees." For example, in July 2021, President Joe Biden launched an effort to promote competition in the American economy, tasking federal agencies with looking for ways that competition is undermined, for example, in

connection with “surprise and opaque” fees or “junk fees.” As part of this effort, the CFPB identified “junk fees” as an area of concern for consumers, citing late fees, overdraft fees, nonsufficient fund fees and bounced check fees. While the CFPB continues to publish reports and information in this space, it also continues to push its enforcement agenda outside of the rulemaking process, bringing enforcement actions and issuing supervisory findings, including in the credit card space, alleging such fees are unfair. The CFPB also has signaled that it intends to examine and investigate such fees under a theory of unfair discrimination.

What does this mean for you?

In light of the proposed rule, covered entities may wish to assess their late fees, considering whether to implement the $8 safe harbor or to utilize a cost analysis by gathering and documenting data to support imposing late fees that exceed $8. In addition, card issuers may need to establish policies and procedures to cap late fees at 25% of the minimum payment of a credit card.

While the proposed rule, if finalized, may change the maximum amount that covered entities may charge for late fees, it also would affect TILA credit card disclosures required under Regulation Z. As a result, covered entities should begin identifying any disclosures that may be impacted by the proposed rule – including advertising disclosures, account-opening disclosures, periodic statements and renewal notices – and start to determine the changes that may need to be made pursuant to any final rule. The supplemental information accompanying the proposed rule provides a list of model disclosures in Regulation Z that may be affected. Covered entities also should consider how they would notify consumers and credit card holders of any changes to late fees, if applicable.

Lastly, entities should keep in mind that the enforcement risk in this space remains real, even while the rule is pending, in light of the more general unfair, deceptive, or abusive acts or practices approach the regulators are taking. This means understanding the assessment of fees, disclosure of those fees (and omissions of other payment methods) and the value inherent in such fees.

Notes

1. 12 CFR §1026 *et al.*
2. 15 USC 1601 *et seq.*

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