



CFPB PROPOSED RULE SLASHES CREDIT CARD LATE FEE SAFE HARBOR

As part of its ongoing battle against “junk fees” and following its request for comment on credit card late payment fees and the fee safe harbor, the Consumer Financial Protection Bureau (“CFPB”) recently issued a notice of proposed rulemaking to amend the Regulation Z credit card penalty fee safe harbor as it applies to credit card late fees from its current rate of \$30 for the first violation and \$41 thereafter to the lesser of \$8 or 25% of the minimum payment. See our [ALERT of June 24, 2022](#). The proposed changes to Regulation Z penalty fees are limited to late fees at this time; however, the CFPB is seeking comments on whether the proposed amendments should apply to other fees as well.

CARD Act Background and Regulatory History

The credit card penalty fee safe harbor was established under Regulation Z through the CARD Act of 2009, which provides that the amount of a penalty fee must be reasonable and proportional to the omission or violation giving rise to the fee and requiring regulation to establish standards for assessing reasonableness and proportionality. 15 U.S.C. § 1665d. The Act also provides considerations that the regulator must consider in issuing rules, which are (i) the *cost incurred* by the creditor from such omission or violation, (ii) the *deterrence* of such omission or violation by the cardholder, (iii) the *conduct of the cardholder* and (iv) such *other factors as the regulator may deem necessary and appropriate*. *Id.* § 1665d(c).

When the CARD Act was enacted, the Federal Reserve Board (“FRB”) was the responsible federal regulator. When setting the initial safe harbor rates, the FRB considered (i) the dollar amounts of penalties currently charged by credit card issuers, (ii) the dollar amounts of penalty fees charged on other types of accounts (*i.e.*, deposit accounts and consumer credit accounts other than credit cards), (iii) state and local law penalty fees and (iv) the safe harbor threshold set by the UK’s Office of Fair Trading in 2006. The FRB’s reports from the initial implementation of the regulations indicate that when the FRB set the initial safe harbor at \$25 for first violations and \$35 for subsequent violations, it believed the amounts were “generally sufficient to cover issuer’s costs *and to deter future violations*.” The FRB considered the costs incurred by both small and large issuers, and seemed to be slightly more concerned with

covering the costs incurred by small issuers than those incurred by large issuers. Following the Dodd-Frank Act, regulatory responsibility for the CARD Act shifted from the FRB to the CFPB.

CFPB Proposed Rule

The CFPB’s proposed rule, touted by the President during his State of the Union address, not only slashes the late fee safe harbor to \$8 (a whopping 75% reduction) but also removes the annual inflation adjustment provision, thereby making the safe harbor subject to change only by formal revisions of the rule. In issuing the proposed rule, the CFPB relied on the broad statutory authority in the CARD Act granting the regulating authority discretion to provide for a safe harbor amount for penalty fees that is presumed to be reasonable or proportional to the omission or violations.

The CFPB considered only four metrics while developing the amendments: (i) late fee income, (ii) collection costs, (iii) late fee amount and (iv) total requirement payments. The CFPB used data collected as part of the FRB’s Y-14M data, which the FRB collects monthly from bank holding companies with total consolidated assets exceeding \$50 billion. The notice states that the Y-14 data accounts for “just under 70%” of outstanding balances on U.S. consumer credit cards as of 2020. However, more than half of banks that issue credit cards are considered small entities with assets of \$850 million or less, and thus are not represented in the Y-14 data. The CFPB recognized that analysis based on Y-14 data may not be representative of such smaller issuers; however, the CFPB argued that it (i) did not receive specific cost data from smaller issuers in response to the request for information in the advance notice of proposed rulemaking and (ii) “has no reason to expect that smaller issuers exhibit substantially higher pre-charge-off collection costs than larger issuers.” In basing the proposed rule largely off data provided only by large issuers, the CFPB reverses course from the FRB, which recognized the importance of considering the impact of safe harbor fees on small issuers when implementing the original safe harbor rate.

While the CARD Act explicitly provides that regulators should consider the deterrence of an omission or violation by the cardholder in issuing rules, the CFPB largely ignored the deterrent effect of late fees in its proposed rule. In fact, the CFPB stated outright that the data upon which it relies does not take into account the possibility that reduced late fees will lead to more late payments. The CFPB

Darrell L. Dreher
ddreher@dtlaw.com

Elizabeth L. Anstaett
eanstaett@dtlaw.com

Mercedes C. Ramsey
mramsey@dtlaw.com

Susan L. Ostrander
sostrander@dtlaw.com

2750 HUNTINGTON CENTER
41 S. HIGH STREET
COLUMBUS, OHIO 43215
TELEPHONE: (614) 628-8000 FACSIMILE: (614) 628-1600
WWW.DTLAW.COM

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Michael C. Tomkies
mtomkies@dtlaw.com

Benjamin J. Hurford
bhurford@dtlaw.com

Judith M. Scheiderer
jscheiderer@dtlaw.com

Robin R. De Leo
robin@deher-la.com



focused almost exclusively on concrete costs that can be represented in dollar amounts, stating that because the responses to the request for information did not provide such specific data, the \$8 proposed safe harbor should be sufficient.

However, the value of late fees in deterring late payments is an important element of a late fee that helps protect consumers in the long-term by acting as negative motivation to pay on time, which protects consumers from detrimental harms, such as the decrease in credit score associated with missed payments.

While not included in the proposed rule's changes, the CFPB's notice of proposed rulemaking suggests that the CFPB is also seeking comment on the following related topics:

- (1) Whether the proposed amendments to the safe harbor should apply to other penalty fees (e.g., over-limit fees, returned payment fees, etc.);
- (2) Whether card issuers should be prohibited from imposing late fees on consumers that make the required payment within 15 calendar days of the due date; and
- (3) Whether the CFPB should eliminate the safe harbor entirely and amend the cost analysis provisions, if necessary.

Industry trade groups largely oppose the proposed rule and have indicated their intent to combat the proposed rule, potentially including litigation. Nonetheless, Director Chopra (and industry) expect the rule will go into effect substantially as currently written. The comment period closes on April 2, 2023, or within 30 days after publication of the Notice of Proposed Rulemaking in the Federal Register, whichever is later. We are happy to help prepare a comment letter or to pass on client comments to industry groups planning to oppose the rule. We will, of course, continue to monitor and report on the status of this proposed rule. □

✧ *Elizabeth Anstaett, Mike Tomkies and Mercedes Ramsey*

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