May 3, 2023

Comment Intake – 2023 NPRM Credit Card Late Fees
c/o Legal Division Docket Manager
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Re: Credit Card Penalty Fees (Regulation Z) (Docket No. CFPB-2023-0010, RIN 3170-AB15); 88 Fed. Reg. 18,906 (Mar. 29, 2023)

Dear Consumer Financial Protection Bureau:

Better Markets Inc.[1] appreciates the opportunity to comment on the above-captioned Proposed Rule ("Proposal" or "Release") issued by the Consumer Financial Protection Bureau ("CFPB" or "Bureau").[2] The Proposal, if adopted, would amend Regulation Z to ensure credit card penalty fees are "reasonable and proportional" to the costs incurred by the creditor for that type of consumer violation or omission. Specifically, the Proposal would: (1) reduce the safe harbor penalty late fee amount from $35 to $8 and from $41 for subsequent violations within six billing cycles to $8; (2) eliminate the annual inflation adjustments for safe harbor late fee amounts; and (3) reduce the limit on late fee amounts from 100 percent to 25 percent of the required payment. We strongly support the Proposal, as it will afford relief to beleaguered consumers and align the penalty fees under the safe harbor with the legal standards that Congress established as well as the currently available empirical evidence.

Last year, the Bureau published a Request for Information ("RFI")[3] asking for public comment on fees imposed by providers of consumer financial products of services. Specifically, the Bureau sought stories, data, and information from the public on the impacts junk fees have had

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

2 Credit Card Penalty Fees (Regulation Z), 88 Fed. Reg. 18,906 (Mar. 29, 2023).

3 Request for Information Regarding Fees Imposed by Providers of Consumer Financial Products or Services, 87 Fed. Reg. 5,801 (Feb. 2, 2022).

and continue to have on peoples' lives. In our Comment Letter[4] in response to that RFI, we applauded the Bureau's effort to conduct a close examination of junk fees and to gather information from all stakeholders, with an eye toward possible reforms that may be necessary to further protect consumers from predatory financial products and services. In that Comment Letter, we advocated that the Bureau should consider using its authority under Regulation Z to ensure open-end credit card issuers are adjusting their penalty fees annually, if greater than allowed by the safe harbor provision, and we also advocated that the Bureau should consider lowering the safe harbor penalty fee amounts.

The Proposal's reduction of the safe harbor late fee amount to $8 more accurately reflects the actual costs incurred by creditors than the original $25 penalty fee ($35 after inflation adjustments), which was based on data that was not available to the Federal Reserve when they initially established the safe harbor. Similarly, the Proposal's elimination of the inflation adjustment for the safe harbor late fee is consistent with Congressional intent and with data showing that inflation is a poor metric for measuring costs incurred by creditors for that violation. Therefore, it is necessary and appropriate for the Bureau to amend Regulation Z as proposed to ensure the safe harbor fee amounts are "reasonable and proportional" to the costs incurred by creditors in accordance with its Congressional mandate.

BACKGROUND

As interest rates fell from their highs in the early 1980s, banks began supplementing their lost revenue from interest by increasing revenue through other means, namely fees and services.[5] While these fees may appear individually modest, such as a $35 credit card late payment fee, they can matter a great deal to some consumers, and collectively they are exacting a huge price from consumers.[6] For example, in 2008 Americans paid roughly $15 billion in credit card penalty fees.[7] Similarly, the average late fee nearly tripled from less than $13 in 1994 to $35 in 2007.[8] In response to the outrageous fees that were being imposed on American consumers, Congress acted to ensure more transparent practices and more fair and reasonable limits on penalty fees in the credit card industry.

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4 Better Markets Comment Letter, Request for Information Regarding Fees Imposed by Providers of Consumer Financial Products or Services, 87 Fed. Reg. 5,801 (Feb. 2, 2022).

5 The Pew Charitable Trusts, *Consumers Need Protection From Excessive Overdraft Costs* 3 (2016), https://www.pewtrusts.org/-/media/assets/2016/12/consumers_need_protection_from_excessive_overdraft_costs.pdf.

6 *See* CFPB, *The Consumer Credit Card Market* 52–54 (2021), https://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-card-market-report_2021.pdf.

7 Fact Sheet: Reforms to Protect American Credit Card Holders, The White House (May 22, 2010), https://obamawhitehouse.archives.gov/the-press-office/fact-sheet-reforms-protect-american-credit-card-holders.

8 H.R. Rep. No. 111-88, at 11 (2009).

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On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure ("CARD") Act was signed into law.[9] The Credit CARD Act made sweeping reforms to the Truth in Lending Act ("TILA") as it related to open-end consumer credit plans, namely credit cards. The law established plain English disclosure requirements for credit card agreements between issuers and consumers, and it regulated the interest rates and penalty fees allowed to be imposed on consumers. Specifically, the new law required credit card penalty fees, including late fees, to be "reasonable and proportional to such omission or violation."[10] The law also gave the regulator at the time, the Board of Governors of the Federal Reserve System ("Federal Reserve"), the optional authority to establish an amount for any penalty fee that was presumed to be reasonable and proportional, otherwise known as a safe harbor.[11]

A little more than a year after the Credit CARD Act became law, the Federal Reserve adopted their final rule amending Regulation Z (which implements TILA), to implement the provisions of the Credit CARD Act.[12] That final rule, consistent with the language of the Credit CARD Act, required credit card issuers to only impose penalty fees that are "reasonable and proportional" to the omission or violation.[13] Additionally, the Federal Reserve included in its final rule a safe harbor for credit card issuers that permits a $25 penalty fee for the first violation and a $35 fee for any subsequent violation within the next six billing periods. The final rule also included an annual inflation adjustment of the safe harbor fee amounts and a limitation on the late fee amount not to exceed 100 percent of the dollar amount associated with the violation (e.g., a consumer cannot be charged more than a $20 late fee when the minimum payment they are required to make is $20).

Shortly after the Federal Reserve finalized amendments to Regulation Z implementing provisions of the Credit CARD Act, Congress transferred regulatory authority from the Federal Reserve to a new financial regulatory agency focused specifically on consumer financial protection. The Dodd-Frank Wall Street Reform and Consumer Protection Act established the Consumer Financial Protection Bureau to "regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws."[14] The Dodd-Frank Act transferred regulatory authority under certain federal consumer financial protection laws such as TILA and Regulation Z solely to the Bureau.[15]

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[9] Pub. L. 111–24, 123 Stat. 1734 (2009).

[10] 15 U.S.C. § 1665d.

[11] 15 U.S.C. § 1665d(e) ("The Bureau, in consultation with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, and the National Credit Union Administration Board, may issue rules to provide an amount for any penalty fee or charge described under subsection (a) that is presumed to be reasonable and proportional to the omission or violation to which the fee or charge relates").

[12] Truth in Lending, 75 Fed. Reg. 37,526 (June 29, 2010).

[13] *Id.* at 37,526*; see also* 15 U.S.C. § 1665d.

[14] 12 U.S.C. § 5491(a).

[15] 12 U.S.C. § 5492.

Aside from the regular inflation adjustments to the penalty fee amounts found in the safe harbor from the Federal Reserve's initial final rule, the "reasonable and proportional" standard has not so far been amended by the Bureau.

While the Credit CARD Act and amended Regulation Z made strides in enhancing disclosures to consumers for open-end credit lending, and in limiting penalty fees, the trend in the banking industry of relying upon fees and services for a greater share of revenue has continued to grow unimpeded by the Credit CARD Act or any other statutes or regulations. For example, prior to the COVID-19 pandemic, credit card penalty fees rose to more than $14 billion in 2019, nearly reaching their pre-Credit CARD Act highs.[16] And despite Congress's intent that credit card penalty fees be based on what were "reasonable and proportional" in relation to the costs incurred by the creditor, the Federal Reserve's safe harbor for penalty fee amounts has instead served as a de facto floor and ceiling for penalty fees divorced from the costs incurred by the creditor. According to the Bureau's analysis, 18 of the top 20 credit card issuers "contracted for a maximum late fee at or within 10 percent of the higher safe harbor amount in 2020."[17] Further, the Bureau found that no credit card issuers used the "reasonable and proportional" cost analysis provisions in Regulation Z to determine the late fees they assess.[18]

SUMMARY OF PROPOSAL

The Proposal seeks to amend provisions in Regulation Z under TILA, which governs the limitation of late fees assessed on credit card accounts. Specifically, Section 1026.52(b) of Regulation Z would be amended to:

1. Reduce the safe harbor dollar amount for late fees to $8 and eliminate a higher safe harbor dollar amount for subsequent violations in the same billing cycle or in one of the next six billing cycles;

2. Eliminate a credit card issuer's ability to make annual inflation adjustments for the safe harbor dollar amounts for late fees;

3. Reduce the limit on late fee amounts from 100 percent to 25 percent of the required payment.

COMMENTS

I. The Credit CARD Act's original safe harbor provision is inconsistent with data available today that equips the Bureau to meet the "reasonable and proportional" standard.

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[16] CFPB, *Credit card late fees* 3 (Mar. 2022), https://files.consumerfinance.gov/f/documents/cfpb_credit-card-late-fees_report_2022-03.pdf.

[17] Release at 18,908.

[18] Release at 18,924.

The Credit CARD Act clearly demonstrates Congress's intent that credit card penalty fees be "reasonable and proportional" to the omission or violation. This language is the standard for determining penalty fees, and it is also the standard the Federal Reserve was required to apply if they exercised their discretion to establish a safe harbor. The Credit CARD Act further specifies what factors the Federal Reserve must take into account in issuing rules, including:

(1) the cost incurred by the creditor from such omission or violation;
(2) the deterrence of such omission or violation by the cardholder;
(3) the conduct of the cardholder; and
(4) such other factors as the Bureau may deem necessary or appropriate.[19]

However, a major deficiency in the Federal Reserve's calculation of its safe harbor penalty fee amounts is that they were admittedly not based on actual costs incurred by credit card issuers or the amounts necessary to deter omissions of violations by cardholders.[20] Those amounts therefore did not comply with the overarching requirement that they be reasonable and proportional in relation to the omission or violation of the consumer.

In its final rule, the Federal Reserve stated that despite requesting data from commenters on the costs incurred to credit card issuers and amounts necessary to deter penalties, they did not receive any data.[21] In the absence of such data, the Federal Reserve was content to rely primarily on the then-current penalty fees chosen by the industry at the time of consideration, which at that time were approximately $36 to 38 dollars for large issuers and $20 to $25 for small issuers.[22] The Federal Reserve adopted this approach even while acknowledging that the industry fee levels were determined largely by the issuers' revenue needs: "rather than basing penalty fees solely on costs and deterrence—most card issuers currently consider a number of additional factors, ***including the need to maintain or increase overall revenue***."[23] Notably, the Federal Reserve was largely silent on its consideration of the deterrence effect when establishing the $25 penalty fee amount.[24] Finally, the Federal Reserve noted that "fees that are substantially lower than the current averages may be sufficient to cover the costs incurred as a result of those violations and to deter such violations."[25] In short, the 2010 rule did not adhere to the "reasonable and proportional" standard that Congress established for credit card penalty fees, nor did it incorporate the factors that must determine those amounts, including creditor costs and the amount necessary to deter cardholder omissions or violations under their contracts.

In light of this flawed approach, it is clearly appropriate for the Bureau to revisit and reset the limits on penalty fees in a manner that better aligns with the statutory criteria. Fortunately, the Bureau has more complete data about the collection costs from issuers in the form of Y-14 data, which has been collected from banks with assets over $50 billion by the Federal Reserve since

[19] 15 U.S.C. § 1665b(c).
[20] *See* 75 Fed. Reg. 37,525, 37,540-37,541.
[21] 75 Fed. Reg. 37,525, 37,541.
[22] 75 Fed. Reg. 37,525, 37,540.
[23] 75 Fed. Reg. 37,525, 37,540 (emphasis added).
[24] Release at 18,914.
[25] 75 Fed. Reg. 37,525, 37,540.

2012. While the Federal Reserve was hamstrung in its ability to calculate a safe harbor for penalty fees due to a lack of data, the Bureau now has access to a treasure trove of data to help them carryout the will of Congress, including considering costs incurred by the creditor for violations and the deterrence effect of any penalty fee amount.

The Bureau's decision to lower the safe harbor to $8 is well-reasoned and supported by the Y-14 data. For example, the Bureau found that in the first three quarters of 2022, total late fee income was $4.46 billion, compared to the pre-charge-off collection costs of $896 million.[26] The Bureau's analysis of Y-14 data found that "the average issuer would recover pre-charge-off collection costs even if late fees were reduced to one-fifth of their current level."[27] By conducting this analysis, the Bureau is better equipped to set a safe harbor for penalty fee amounts that considers costs incurred by creditors, which was importantly left out of the Federal Reserve's initial analysis in setting their safe harbor fee amounts. In identifying that issuers can recover pre-charge-off collection costs at one-fifth of the current level ($35) they are able to issue a safe harbor that better reflects the factors that Congress mandated in the Credit CARD Act—something missing from the Federal Reserve's final rule.

Additionally, consistent with the text of the law, the Bureau also considered whether or not the $8 fee would still have a deterrent effect on late payments. The Bureau "considered (1) a comparison of the proposed $8 late payment safe harbor amount to minimum payment amounts on the account in the Y-14 data; and (2) available empirical evidence on the effects of credit card late fees on the prevalence of late payments."[28] The Bureau's analysis concluded that the $8 safe harbor amount would still have a deterrent effect for the first and subsequent late payments.

A safe harbor for penalty fees set at $8 more accurately reflects the costs incurred by creditors than the original $25 penalty fee (now $35 after inflation adjustments). It is necessary and appropriate for the Bureau to include such quantifiable costs in its analysis in establishing a safe harbor because it is mandated by Congress. Because the Bureau's Proposal includes such costs, it is a marked improvement from the Federal Reserve's final rule and more accurately reflects penalty fees that are "reasonable and proportional" to the violation.

II. Inflation adjustments for safe harbor penalty fee amounts are inconsistent with the Credit CARD Act and inconsistent with reality.

In its 2010 final rule, the Federal Reserve included an annual adjustment to the safe harbor amounts to reflect changes in the Consumer Price Index ("CPI").[29] That is how the safe harbor amounts increased from a $25 penalty fee for the first violation and a $35 penalty fee for each subsequent violation within the next six billing cycles in the Federal Reserve's final rule to the substantially higher $30 penalty fee for the first violation and $41 penalty fee for each subsequent violation. The Federal Reserve's inflation adjustment to the safe harbor was an overly blunt and

[26] Release at 18,916.
[27] Release at 18,916.
[28] Release at 18,919.
[29] *See* 75 Fed. Reg. 37,525.

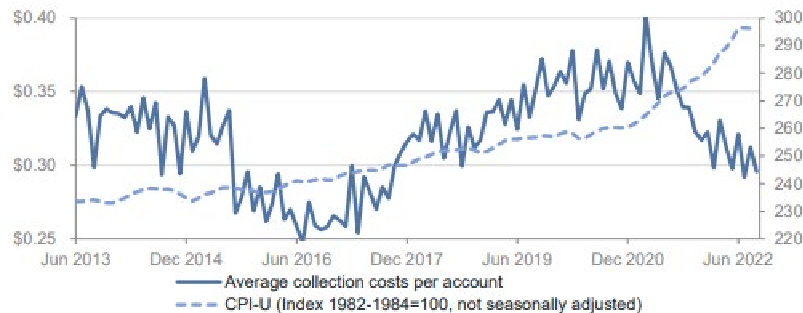
broad instrument for ensuring that the fee amounts were "reasonable and proportional" over time without having to revisit them through the rulemaking process. Instead, this crude metric enabled the safe harbor penalty fee amounts to detach from any reasonable interpretation of the "reasonable and proportional" standard mandated by Congress. The Federal Reserve itself acknowledged that inflation adjustments were "not a perfect substitute" to ensuring "reasonable and proportional" penalty fees.[30] Nevertheless, the Federal Reserve used this method because they believed it would sufficiently account for the "changes in issuers' costs and the deterrent effect" over time and avoid the need for additional rulemaking in the future. This approach was flawed from its inception because it was based on the incorrect assumption that costs to issuers and amounts necessary to deter consumers would rise with inflation, despite any evidence that these amounts would actually move in tandem with inflation.

In issuing the final rule, the Federal Reserve rejected the arguments from consumer groups that opposed inflation adjustments to the safe harbor penalty fee amounts. Those groups argued that changes in CPI are not necessarily correlated with changes in costs incurred by issuers for violations.[31] The Federal Reserve nevertheless chose to shortcut the regulatory process so they would not have to reassess the safe harbor fee amounts in any future rulemaking. This approach violated the mandate given to the Federal Reserve by Congress because (1) as discussed in the Proposal, collection costs are, in fact, not correlated to CPI, and (2) Congress did not include any language about indexing these penalty fees to inflation as they have done in other laws.

In revisiting the safe harbor fee amounts in Regulation Z for credit cards, the Bureau is aided by more substantive data than that which was utilized or available to the Federal Reserve when it originally finalized the rule. Specifically, the Bureau has now analyzed and relied on Y-14 data that has been collected monthly by the Federal Reserve since 2012.[32] This data relates to bank holding companies with $50 billion in assets, which accounted for nearly "70 percent of outstanding balances on U.S. consumer credit cards as of year-end 2020." That body of data, therefore, serves as a fair proxy for the industry as a whole.[33] The Proposal's decision to abandon the flawed inflation adjustment is grounded in this data, unlike the Federal Reserve's approach when it decided to implement the inflation adjustment provision. It is now clear from Y-14 data and the analysis in the Proposal (highlighted in Figure 2 below) that the average collection costs as a result of late fees are not correlated with the CPI.[34]

[30] 75 Fed. Reg. 37,525, 37,543.
[31] 75 Fed. Reg. 37,525, 37,543.
[32] Release at 18,910.
[33] Release at 18,910.
[34] Release at 18,926.

Figure 2: Collection Cost and Price Index Trends (Y-14)



It would be a mistake for the Bureau to move forward with any proposed rule that retains this flawed metric of using CPI to establish "reasonable and proportional" penalty fee amounts.

Not only is the decision by the Federal Reserve to adjust the safe harbor fee amounts for inflation inconsistent with the "reasonable and proportional" standard mandated by Congress, as evidenced by the Y+14 data, but there is also no evidence to suggest that Congress intended for an inflation adjustment to be included in the calculation of what is "reasonable and proportional" or in fashioning the safe harbor. In, fact, there is strong evidence that Congress never intended the safe harbor fee amounts to be indexed for inflation. The Credit CARD Act does not include any references to inflation adjustments in its text, let alone as it relates to what is "reasonable and proportional" for the purposes of determining penalty fee amounts. While the omission of this language may not be determinative, it is certainly persuasive considering Congress has regularly included such language in other laws.[35]

In short, legislative intent as well as empirical analysis support the Bureau's decision to eliminate the inflation adjustment of the safe harbor penalty fee amounts. Congress declined to include inflation as a metric for penalty fees, and the Y+14 data clearly demonstrates no correlation between CPI and the average collection costs for penalty fees.

[35] *See e.g.*, 15 USC § 1604 (Congress allowed for the CFPB to index for inflation waivers for certain borrowers from mortgage disclosures); 15 USC 1667 (Congress required nominal levels established to meet the definition of "consumer lease" to be indexed for inflation); 15 USC 78fff-3 (Congress gave authority for SIPC advances to be adjusted for inflation); 15 USC 77b (Congress mandated the nominal levels within the definition of an "emerging growth company" to be indexed for inflation every 5 years). These are but a few examples within Title 15 alone in which Congress required or allowed nominal levels to be indexed for inflation.

CONCLUSION

We hope these comments are helpful as the Bureau finalizes the Proposal.

Sincerely,

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