



# CFPB – Overdraft Lending: Very Large Financial Institutions

## Executive Summary

January 31, 2024

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On January 17, 2024, the Consumer Financial Protection Bureau (CFPB) issued its notice of proposed rulemaking regarding proposed changes to overdraft fee rules for certain financial institutions, including credit unions. In the long-awaited anticipated notice, the aim is to extend consumer credit protections to certain overdraft credit provided by very large financial institutions, those exceeding \$10 billion in assets.

### I. Key Takeaways

- Covered institutions would be allowed to choose whether to offer overdrafts as a “courtesy overdraft service” or as a line of credit (loan).
- If providing “courtesy overdraft service,” the covered institution must charge a “breakeven” amount for the service, either: (i) its direct costs to provide the service; or (ii) a benchmark fee (in an amount to be determined, either \$3, \$6, \$7, or \$14). (Such an overdraft service is referred to as “breakeven overdraft credit.”)
- The comment period ends on April 1, 2024.
- The CFPB expects that this proposal would take effect in October 2025.

### II. Impact on Credit Unions

If the CFPB's proposal is finalized in its current form, it would bring significant changes to the structure of overdraft courtesy pay fees. Covered credit unions would be required to demonstrate a "break even" point for each transaction involving an overdraft fee or establish a safe harbor overdraft fee ranging from \$3 to \$14 (the specific amount to be determined in the final rule). Given the potential drastic shift in average overdraft fees, maintaining this service could become challenging for credit unions under the proposed rule. This, in turn, might lead to serious consequences for consumers facing a cash shortfall, forcing them to turn to payday lenders for essential purchases. Additionally, although the proposal currently exempts financial institutions with assets less than \$10 billion, the CFPB has hinted at reconsidering this threshold. Therefore, credit unions under this threshold should be attentive to the concerns the CFPB aims to address through this rulemaking.

### III. Background – How Are Overdraft Fees Currently Regulated?

Overdraft products and services generally have been exempted from regulation as consumer credit. Since 1969, when the Federal Reserve Board (FRB) issued Regulation Z implementing Truth in Lending Act (TILA), charges imposed by financial institutions for honoring overdrafts have not been considered a “finance charge” unless the financial institution has agreed in writing to honor the overdrafts in return for a fee.

The exemption from Regulation Z has been supported to date by language in deposit agreements that provide credit unions with discretion to pay or not pay an overdraft, which distinguishes overdraft fees from “finance charges.” As a result, honoring an overdraft does not make a bank a “creditor” with respect to that discretionary transaction, subject to Regulation Z.

Regulation Z also makes clear that debit cards are generally not “credit cards,” even if their use results in an overdraft, and that banks that allow consumers to overdraw their account with a debit card and honor that overdraft are, therefore, not “card issuers” subject to additional provisions of Regulation Z. [See 12 CFR §1026, Comment 2(a)(15)-2.ii.A.]

Instead, overdraft has traditionally been regulated as a feature of a transactional deposit account under Regulation DD (implementing the Truth in Savings Act) and Regulation E (implementing the Electronic Fund Transfer Act). Regulation DD requires disclosures regarding the fees a depository institution charges for honoring an overdraft in advertisements, account opening disclosures and periodic statements. Regulation E requires disclosures and consumers “opt-in” to an overdraft service before a bank can charge fees when consumers overdraw their account through an ATM or one-time debit transaction – but these requirements do not apply to other types of transactions that result in overdrafts. It also exempts credit extended pursuant to an “overdraft credit plan” from the generally applicable prohibition on conditioning the extension of credit on the consumer’s agreement to repay by preauthorized electronic fund transfer.

In 2016, the CFPB amended Regulation Z to provide that prepaid accounts that paid overdrafts were generally subject to Regulation Z’s rules governing credit cards. Its rationale at the time presaged much of its rationale for this proposed rule: the historical reasons that the FRB exempted ad-hoc coverage of overdrafts – almost always from checks – from Regulation Z did not apply to prepaid products, which (unlike checks) could be declined by merchants on the spot when there was an insufficient balance and therefore generally would not result in NSF fees, fees from merchants and even potential criminal liability for passing bad checks.

Finally, overdraft services are – and will remain – subject to state and federal prohibitions on unfair, deceptive and abusive acts and practices, which recently has been the regulators’ principal tool for policing overdraft practices.

#### **IV. Key Provisions of the Proposed Rule**

The following briefly highlights the key provisions to the proposed rule.

##### **A. Who is covered?**

Proposed rule would apply to “very large financial institutions” (*an insured depository institution or an insured credit union that has total assets of more than \$10 billion and any affiliate thereof, as determined under 12 U.S.C. 5515(a)*). Smaller institutions with less than \$10 billion in assets are exempt from this proposal.

##### **Additional Considerations**

- The CFPB indicates that the proposal would cover financial institutions holding approximately 80 percent of consumer deposits as of December 2022 and responsible for approximately 68 percent of overdraft charges as of December 2022.
- The CFPB believes that consumers at very large financial institutions would benefit from the expanded protections that would be provided by the proposed rule.

- While the CFPB is not proposing any changes to the regulatory requirements for smaller financial institutions, the CFPB indicated that it will continue to monitor the market in coordination with state and federal supervisors.

## B. Key Definitions

The proposal has notable key definition changes:

1. **Finance charge** – The proposal would amend the definition of “finance charge” in §1026.4 in three ways:
  1. Modifies the partial exception provided in §1026.4(b)(2) for certain charges imposed on checking and other transaction accounts so that the partial exception would no longer apply to “covered asset accounts” as defined in proposed §1026.62.
  2. Adds proposed §1026.4(b)(12) that would provide examples of charges imposed in connection with covered overdraft credit that are finance charges.
  3. Amends the exception provided in §1026.4(c)(3) so that the exception would no longer apply to “above breakeven overdraft credit” as defined in proposed §1026.62.
2. **Open-credit** – Regardless of whether the financial institution assesses such charges on the deposit account itself or a separate credit account, any service, transaction, activity, or carrying charges imposed by a financial institution for paying a transaction that overdraws a consumer’s deposit account held at the financial institution are finance charges unless they are excluded from the definition of finance charge by § 1026.4(c).

The proposed rule also creates several new definitions for key terms in the proposed changes, including:

- **Overdraft credit** – Any consumer credit extended by a financial institution to pay a transaction from a checking or other transaction account (other than a prepaid account as defined in §1026.61) held at the financial institution when the consumer has insufficient or unavailable funds in that account. The term overdraft credit includes, but is not limited to, any such consumer credit extended through a transfer from a credit card account or overdraft line of credit.
- **Above breakeven overdraft credit** – overdraft credit extended by a very large financial institution to pay a transaction on which, as an incident to or a condition of the overdraft credit, the very large financial institution imposes a charge or combination of charges exceeding the average of its costs and charge-off losses for providing non-covered overdraft credit.
- **Covered asset account** – A checking or other transaction account (other than a prepaid account as defined in § 1026.61) provided by a very large financial institution that is tied to overdraft credit provided by the very large financial institution.
- **Covered overdraft credit** – Overdraft credit that is subject to a finance charge or is payable by written agreement in more than four installments.
- **Hybrid debit-credit card** – Any card, plate, or other single credit device that a consumer may use from time to time to obtain covered overdraft credit from a very large financial institution.
- **Non-covered overdraft credit** – Overdraft credit that is not subject to a finance charge and is not payable by written agreement in more than four installments.\

## C. What transactions and accounts are covered?

- *Overdraft Fee Restrictions*

The proposal would provide a new structure for determining – and limiting – the fees that “very large financial institutions” may charge for overdraft services. While covered credit unions can continue to provide courtesy overdraft credit, the fees they can charge would be assessed against a new breakeven

standard or a benchmark fee. If the fees are equal to or less than these metrics, the overdraft credit provided would *not* be subject to Regulation Z.

- **Breakeven Standard**

Under the proposal, a covered credit union would determine whether an overdraft fee is “above breakeven overdraft credit” if the “charge or combination of charges” exceeds the greater of:

1. The pro rata share of the covered credit union’s annual total direct costs and charge-off losses related to providing overdraft services; or
2. An estimate to be published by the CFPB.

To use the breakeven fee approach, a covered credit union would have to determine its total direct costs and charge-off losses for providing non-covered overdraft credit to all accounts open at any point during the previous 12 months and then divide that figure by the total number of non-covered overdraft transactions attributable to those accounts occurring within the previous 12 months. However, the CFPB made clear that certain kinds of costs should not be included in the calculation of costs under the breakeven standard (e.g., general overhead costs and charge-off losses resulting from, for example, unauthorized use and billing errors).

- **Benchmark Fee**

Under the proposal, the CFPB considers four options for the benchmark fee (\$3, \$6, \$7, and \$14). The alternatives each use the same general formula, but they use different reasoning and different data points. Generally, the CFPB determined total charge-off losses, excluding certain losses (e.g., losses attributable to unauthorized use and billing errors), and then added \$1 to the charge-off loss per transaction calculation to account for a financial institution’s cost of funds and operational costs.

- **\$3 benchmark fee** – Based on charge-off loss per transaction for the five financial institutions in the CFPB’s sample;
- **\$6 benchmark fee** – Based on the same sample data, but when calculating the charge-off loss per transaction, this alternative considered only non-covered overdraft transactions that resulted in an overdraft fee;
- **\$7 benchmark fee** – Based on charge-off losses for the financial institution in the sample with the highest charge-off losses; and
- **\$14 benchmark fee** – Uses the same approach as the \$7 benchmark fee, but (like the \$6 benchmark fee) considered only non-covered overdraft transactions that resulted in an overdraft fee.

- *Extending Regulation Z to Higher Priced Overdraft Services*

Overdraft credit can be provided at a cost higher than the breakeven standard or the benchmark fees, but above those thresholds it would be subject to a new section within Regulation Z (§1026.62).

The proposal indicates that if a covered credit union would charge more for honoring an overdraft than its average costs and charge-off losses, the charge would be considered a “finance charge,” and honoring the overdraft would be regarded as an extension of “covered overdraft credit.”

A covered credit union charging such fees would be required to establish a credit account for the member (separate from the member’s asset account).

- **Structure of covered overdraft credit**

The CFPB is proposing changes to Regulation Z regarding the structure of overdraft credit offered by very large financial institutions.

1. **Structural prohibition** – The CFPB proposes to prohibit very large financial institutions from treating any overdraft as a negative balance on a linked checking account or other asset account. Instead, the proposal would require very large financial institutions to structure it as a separate credit account.
2. **Offset prohibition** – Regulation Z generally prohibits the practice of immediately taking funds from incoming deposits to repay overdraft credit balances. The proposal would reinforce this prohibition by requiring the separation of asset balances and credit balances.
3. **Credit account opening** – When opening a covered overdraft credit account, covered credit unions must adhere to certain requirements and protections, including providing account opening disclosures to the member for the covered overdraft credit account before the member makes the first transaction under the covered overdraft credit plan.
4. **Disclosure requirements** – Covered credit unions must comply with the existing disclosure requirements in Regulation Z when providing above breakeven overdraft credit to members through a covered overdraft credit account.
5. **Credit subaccounts** – The proposal would establish that a credit subaccount is a type of covered overdraft credit account.
6. **Existing overdraft lines of credit** – Overdraft lines of credit that many very large financial institutions currently provide would be covered overdraft credit accounts, regardless of whether they are above or below the breakeven pricing under the proposed rule. However, Some Regulation Z requirements, like change-in-terms notices, would continue to apply to these existing lines of credit.

- **Credit Card Changes**

The CFPB proposed changes to the Credit Card Accountability Responsibility and Disclosure (CARD) Act provisions in Regulation Z.

1. **Current Regulation Z requirements** – Credit cards and card issuers are generally subject to additional requirements in Regulation Z. The requirements that apply generally depend on whether the credit account can be accessed by a “credit card,” “credit card account under an open-end (not home-secured) consumer credit plan,” or “charge card” under Regulation Z.
2. **Proposed changes** – The CFPB is proposing to subject all covered overdraft credit to the CARD Act provisions of Regulation Z if that credit is:
  - Open-end credit;
  - Accessible by a credit card; and
  - Offered by a very large financial institution.
3. **Exceptions to CARD Act provisions** – Currently, certain overdraft lines of credit accessed by debit cards are exceptions to the CARD Act provisions due to non-statutory exceptions created by the Board. The CFPB is proposing to remove these exceptions for very large financial institutions.

Additionally, the proposed rule includes changes to the special credit card provisions under § 1026.12 of Regulation Z.

1. **Special credit card provisions** – Clarifies how the special card provisions apply to “hybrid debit-credit cards.” The proposal would provide additional guidance on unsolicited issuance in §1026.12(a) and the right of a cardholder to assert claims or defenses against a card issuer in § 1026.12(c).
2. **Clarification to issuance of credit cards** – TILA section 132 generally prohibits creditors from issuing credit cards except in response to a request or an application. TILA section 132 explicitly exempts credit cards issued as renewals of or substitutes for previously accepted credit cards from this prohibition. The proposal would provide guidance on how the prohibition on issuing unsolicited credit cards applies to hybrid debit-credit cards.

3. **Right of cardholder to assert claims or defenses against card issuer** – TILA section 170 generally provides that the cardholder may assert against the card issuer all claims (other than tort claims) and defenses arising out of the transaction. The proposal narrows the overdraft exception to include hybrid debit-credit cards. It also revises commentary for § 1026.12(c)(1) to provide examples related to hybrid debit-credit cards.
4. **Credit card applications and solicitations** – The proposal would apply requirements related to applications and solicitations for credit cards to covered overdraft credit accessed by a hybrid debit-credit card.
5. **Charge card** – The CFPB proposes to amend the definition of “charge card” to exclude a hybrid debit-credit card from the definition. Under the proposed amendment, a hybrid debit-credit card would be subject to the same disclosure and other rules as other credit cards, rather than certain special rules for charge cards.

- **Compulsory use of preauthorized transfers**

Covered credit unions would be subject to the compulsory use provision under Regulation E, which prohibits requiring members to use preauthorized electronic fund transfers for repayment of overdraft credit. As a result, covered credit unions could not condition the provision of overdraft services on the member's agreement to permit automatic payments from the consumer's checking account. While a member may still be given the choice to opt into automatic payments, the proposal would allow members to use at least one alternative method of repayment.

## V. Comment Deadline

- April 1, 2024

## VI. Resources

- [Docket No. CFPB-2024-0002](#)

## VII. Questions to Consider

1. When finalized, what method would you likely choose?
  - Charge the “above breakeven” overdraft fee and comply with Regulation Z, E, and CARD Act requirements?
  - Charge a “breakeven” amount that allows the credit union to only recoup the cost of providing the overdraft. (Calculated annually. Would not be subject to Regulation Z, E, and CARD Act requirements.)
  - Charge the safe harbor amount that the CFPB establishes. The CFPB is considering setting the benchmark fee at \$3, \$6, \$7, or \$14. (Would not be subject to Regulation Z, E, and CARD Act requirements.)
  - Provide courtesy overdraft at no charge.
  - Remove overdraft program.
2. What range of actions would your credit union take to account for a cap on overdraft fees? How would these actions differ for the smallest cap of \$3 versus the largest of \$14?
3. How might the not-yet-finalized safe harbor cap (range from \$3 to \$14) for overdraft fees impact consumers differently based on their financial circumstances, and what measures could be taken to ensure that the fees remain fair and transparent?
4. What potential unintended consequences could arise from establishing such a safe harbor fee cap for overdraft fees, particularly in terms of incentivizing financial institutions to maximize fees rather than promote responsible financial management?
5. Do you think that the proposal should address a de minimis exception rather than removing a program that many members have opted into with full disclosure of the terms? If so, what factors should be considered to ensure that it effectively protects vulnerable consumers from

disproportionately high fees while still allowing for the flexibility and convenience that overdraft programs offer to individuals facing temporary financial challenges?

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