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CFPB: Fixing Something That's Not Broken–But Setting Forth a Framework for Abusive Conduct

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Introduction

The Consumer Financial Protection Bureau ("CFPB" or "Bureau") recently issued a proposed rule that would prohibit financial institutions from charging nonsufficient funds ("NSF") fees on instantaneously declined transactions. The proposed rule would prevent fees that the CFPB admits are rarely charged. Most financial institutions generally charge customers a fee for declined transactions that do not occur instantaneously, such as check or ACH transactions. The proposed rule, however, looks ahead to anticipated advancements in technology that "may eventually make instantaneous payments ubiquitous." In preparation for this eventuality, the Bureau asserts that it is necessary, here, to "proactively set regulations to protect consumers from abusive practices."[1]

Perhaps, just as importantly, the proposed rule offers insights into how the Bureau views the threats to consumer protection from innovations in the payments industry and provides significant guidance as to how the CFPB's understanding of "abusive conduct" continues to evolve.

The Proposed Rule

The proposed rule on its face prohibits financial institutions from charging NSF fees[2] on transactions that are instantaneously declined, because the customer lacks sufficient funds. The proposed rule borrows both the definition of a "covered financial institution" and an "account" from Regulation E.[3] Those provisions of Regulation E, of course, often fail to reflect the modern movement of money.

The rule also defines a "covered transaction" as "an attempt by a consumer to withdraw, debit, pay, or transfer funds from their account that is declined instantaneously or near-instantaneously by a covered financial institution due to insufficient funds."[4] For purposes of the proposed rule, "instantaneously or near-instantaneously" means that to the consumer there is no significant perceptible delay in the processing of the transaction.[5] As such, traditional payment methods, including physical checks and transactions through the automatic clearing house, which have a delay between the initiation of the transaction and the processing of the transaction, would not fall under the prohibition.

The CFPB Uses This Proposed Rulemaking To Build-Out Its Abusive Doctrine

The CFPB relies on Section 1031(b) of the Consumer Financial Protection Act, and specifically its authority to prohibit abusive acts or practices. Conduct is abusive, when among other things, "the act or practice takes unreasonable advantage of a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service."[6]

The Rule also engages with a long-standing dynamic at the CFPB: whether a disclosure regime or a product suitability determination is the best way to address a perceived problem in the marketplace. The proposed rule suggests a disclosure regime, here, may not sufficiently protect consumers in many instances.

The Bureau explains that it specifically considered whether a disclosure regime should be the proper way to protect consumers from the imposition of NSF fees, and ultimately determined that disclosures would be costly and may not effectively provide consumers with the requisite notice and information.[7] Furthermore, the CFPB notes that well-crafted disclosures by themselves would not provide adequate consumer protection in some instances.[8] Accordingly, the proposed rule suggests that a disclosure likely cannot adequately address "abusive conduct."

In addition, the proposed rule seeks to clarify certain points that inform the Bureau's interpretation of what constitutes abusive conduct. To this end, the Bureau points to a 2020 rulemaking that reinterpreted the CFPB's 2017 rule on payday, vehicle title, and certain high-cost installment loans. Here the CFPB argues that the 2020 rule conflated the concepts of "lack-of-understanding" and "reasonable-avoidability."[9] Now the CFPB seeks to distinguish between these concepts, and in doing so, provides much of the justification as to why a disclosure regime would not mitigate abusive conduct. The CFPB explains that while consumer disclosures may contribute to the avoidability of consumer harm, disclosures may not be sufficient if a consumer does not understand the disclosure.[10]

Moreover, the proposed rule clarifies that a consumer's understanding of "risks" is likely different from a consumer's understanding of "costs" or "conditions." The proposed rule explains that a company may take "unreasonable advantage of the fact that consumers do not know a fee ('cost') will be charged in a particular circumstance, even if consumers have some understanding of the 'risk' that a fee might sometimes be charged."[11] As such, the proposed rule finds that when a consumer does not appreciate the costs associated with a transaction, the "likelihood and magnitude of harm," a concept connected to the concept of "risk," might not inform what a consumer understands about the cost of the transaction.[12]

The CFPB's proposed rule does more than simply address the ever-dwindling imposition of NSF fees. The Rule, perhaps more importantly, articulates the Bureau's ever-expanding UDAAP doctrine, and provides a new roadmap for how all consumer financial services companies should be thinking about how the Bureau views its authority to prohibit abusive acts or practices under the CFPA.

Institutions should consider participating in this rulemaking through the comment period, which runs until March 25, 2024, to provide insight on how payment products actually work, the types of fees actually involved and why the current disclosure regimes work or do not work for consumer protection. Paul Hastings attorneys are actively advising clients on this and many other CFPB initiatives.

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[1] Fees for Instantaneously Declined Transactions, 89 Fed. Reg. 6032 (proposed Jan. 31, 2024) (to be codified at 12 C.F.R pt. 1042).

[2] An NSF fee differs from an overdraft fee because the fee is only charged when a transaction is declined, while an overdraft fee is assessed to a consumer to complete the transaction despite the lack of sufficient funds. *See* Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6037.

[3] *Id*. at 6036 (citing 12 CFR 1005.17(b)(2)).

[4] *Id*. at 6050.

[5] *Id.* at 6037.

[6] *Id*. at 6038 (citing 12 U.S.C. 5531(d)(2)(A)).

[7] *See id*. at 6038.

[8] *See id*.

[9] *See id.* at 6308–6309.

[10] The Bureau issued a Policy Statement on Abusive Acts or Practices Statement in April 2023, in which the Bureau also sought to clarify the meaning of "abusive conduct." *See* *Policy Statement on Abusive Acts or Practices*, CFPB (Apr. 3, 2023). The Bureau heavily relies on that statement in supporting its "preliminary findings" in the proposed rule, including to explain that whether conduct is abusive turns on a consumer's lack of understanding.

[11] *See* Fees for Instantaneously Declined Transactions, 89 Fed. Reg. at 6040.

[12] *See id*.

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