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INSIGHT

CFPB Proposes New Credit Card Late Fee Regulation

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On March 29, 2023, the Consumer Financial Protection Bureau (CFPB) issued a Notice of Proposed Rulemaking to reduce late fees on credit cards. The rulemaking would amend Regulation Z, which implements the Truth in Lending Act (TILA; 15 U.S.C. §§1601 et seq.), by reducing the credit card late fee safe harbor to $8 (generally from $30 now). The CFPB is currently receiving comments on its proposed rule before it is finalized.

This rulemaking is a part of a larger White House initiative called the President's Competition Council, which is intended to "promote competition in the American economy" by limiting "junk fees." According to the CFPB, "junk fees" in consumer financial markets may include late fees, overdraft fees, out-of-network ATM fees, and inactivity fees, among other things.

This Insight provides an overview of the credit card fee regulation and analyzes major parts of the CFPB's proposed rule.

Background

Credit cards allow a consumer to pay for transactions using unsecured revolving credit, meaning the loan is not secured with any collateral if the consumer defaults. According to the CFPB, over 180 million consumers—roughly 70% of U.S. adults—have credit cards, making it the most widely used consumer credit product.

The 2009 Credit Card Accountability Responsibility and Disclosure Act (CARD Act; P.L. 111-24) established new disclosure and fee requirements for credit cards, among other things. In particular, the law requires that penalty fees, such as late payment fees, "shall be reasonable and proportional." It tasks the CFPB to establish standards by considering the creditor's cost, the deterrence effect, the conduct of the cardholder, and other factors that the CFPB deems "necessary or appropriate." The CFPB may also establish a safe harbor amount for penalty fees, which would specify an amount that complies with the law, allowing credit card companies to ensure that they are in compliance. A 2010 regulation adopted this approach to limit penalty fees, adjusted for inflation. The regulation currently establishes a safe harbor of $30 initially and $41 for each subsequent violation.

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CFPB research finds that the average credit card late fee charged was $31, and late fees accounted for nearly half of consumer fees and about a tenth of consumers' total cost of credit (interest and fees). Consumers with subprime credit scores are more likely to incur late fees. Many of the largest card issuers charge at or near the safe harbor level established by the regulation, while smaller banks and credit unions tend to charge less. In June 2022, the CFPB published an advanced notice of proposed rulemaking seeking information on credit card late fees to inform this rulemaking.

CFPB's Proposed Regulation

Cost of Late Fees

The proposal would lower the safe harbor for late fees to $8 for initial and subsequent violations. The CFPB determines that an $8 late fee would allow card issuers to recover average pre-charge-off collection costs from late payments, for example, by notifying consumers of their late payments and helping resolve them. The CFPB estimates that this would reduce credit card late fees by about 75% for consumers.

The proposal would also no longer adjust the late fee safe harbor for inflation. The CFPB determined that inflation is not necessarily reflective of the cost of late payments to credit card issuers over time.

The CFPB argues that current late fees are not "reasonable and proportional," because credit card issuers currently generate more revenue from late fees than their cost of late payments. The CFPB also argues that when consumers shop for credit cards, they may not consider late fees, because such fees are "back-end." Therefore, CFPB argues that this proposal would lower consumer costs and increase transparency.

The lending industry argues that lowering late fees would increase costs on credit card issuers, causing them to reduce credit access and increase interest rates, particularly for subprime consumers.

Deterring Late Payments

Late fees also act as a deterrent, and recent academic research finds that when late fees are lower, people are more likely to pay late and incur the late fee. At the same time, subprime cardholders tend to pay down credit card debt in response to lower late fees and so may pay less in interest over time. Therefore, the impact of late fees on consumer financial health is mixed.

The CFPB argues that while consumers may be late more frequently with reduced fees, there are other consequences that deter late payments, such as negative impacts on a consumer's credit score. Lower late fees could also incentivize card issuers to help consumers pay on time, such as by encouraging payment reminders.

Industry and other critics argue that late fees promote repayment of credit cards, and lowering late fees may cause the cost of credit to increase, potentially harming consumers who pay on time. They argue that the CFPB's proposal ignores the deterrence effect of late fees and fails to recognize the competitive credit card market.

Impact on Small Institutions

The CFPB is required to complete a small business review process (SBREFA) for certain rulemakings to obtain input from impacted small entities in the rulemaking process. In this rulemaking, the CFPB asserts that the SBREFA process is not required because the proposal would not have a "significant economic impact on a substantial number of small entities," as credit cards may be less than 5% of most small banks' and credit unions' assets and revenues.

Some industry groups argue that a SBREFA analysis should have been done and that it may have led the CFPB to different conclusions. According to industry analysis, more than half of credit-card-issuing banks and 85% of credit-card-issuing credit unions are small. In addition, some of the data that the CFPB relied on in its analysis may not be representative of smaller issuers. For example, some smaller institutions may serve more subprime consumers who are more likely to be late, making these institutions' late payment costs higher than average. Therefore, from this perspective, a SBREFA process may have informed the rule's impact on smaller entities.

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