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How Much is Too Much?

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Growing up in New England we both heard that there were three things you should never discuss in public. Politics and religion were two. The third could differ. In Connecticut (the neutral zone between New York and Red Sox Nation) it was best to avoid sports. And discussing income and money was also taboo. You entered a conversation on any of these topics at you peril. Too often they ended in argument, misunderstanding, and hurt feelings. Unfortunately, based on what appears in the media and social media, that rule of etiquette is long gone. And from this sea of "discourse" one thing is clear: we cannot agree on anything. Maybe with one exception.

Fees. They are universally unpopular. No one wants to pay more for something than they feel they should. Especially when times are tight. So, it is understandable that fees have been a key focus of the Biden Administration and federal regulators, including the CFPB. But recent fee-related guidance seems to evidence increasing focus on the spread between the cost to the service provider and the cost to the consumer, with diminishing emphasis on whether the permissibility of a fee (in assessment and amount) is rooted in a statute or regulation. Where this is going is the key question.

The CFPB march on "junk fees" in the financial services industry kicked off a little over a year ago with a request for public comment. This request focused on fees that were mandatory or quasi-mandatory and that were added without clear up-front disclosure. The CFPB's concern - rightfully so - is that such "hidden fees" obscure the actual cost of a financial product or service. This effort recently culminated with CFPB's *Supervisory Highlights: Junk Fees Special Edition* published on March 8th ("Supervisory Highlights").

The Supervisory Highlights details a number of fees assessed on deposit accounts, in the servicing of auto, mortgage and student loan accounts, and in the payday and small dollar lending space. The nature and amounts of these fees vary widely. However, the common thread weaving them together is that the CFPB considered all of them to be "unnecessary charges that inflate costs while adding little to no value to the consumer." The legal angle taken by the CFPB to combat these fees is to consider them "unfair."

Methods of competition deemed "unfair" have been illegal under the Federal Trade Commission (FTC) Act for over a century. However, what is "unfair" is not subject to easy definition. Aside from fact-specific case law, the first broad attempt at defining this term arrived in 1980 with the FTC Policy Statement on Unfairness (the "Policy Statement"). The Policy Statement distilled the interpretive parameters used when determining if an act or practice was "unfair," and articulated three factors to consider when making that determination. First, does the practice injure consumers? Second, does the act or practice violate established public policy? Finally, is the act or practice "unethical or unscrupulous." Much of the focus of the Policy Statement is on the first factor, with final two factors relegated largely to surplusage.

To determine if an act or practice violates the consumer injury standard of the Policy Statement, three steps must be fulfilled. First, the injury -- which is often financial in nature -- must be "substantial." Second, the injury must not be outweighed by any offsetting consumer or competitive benefits. Finally, the injury must be one not reasonably avoidable by the consumer. In 1994, the FTC Act was amended to codify this three-step consumer injury analysis, and to limit the scope of FTC inquiry under the unfairness doctrine solely to instances where consumer injury occurred.

The FTC is granted enforcement responsibility under the FTC Act. Notably, banks are excluded from the scope of this mandate. However, this "loophole" (if there ever was one) was closed by the bank regulators in the early aughts. The Federal Reserve, FDIC, and OCC each issued supervisory guidance confirming their ability to enforce the FTC Act against their regulated entities, institution affiliated parties, and operating subsidiaries. Interesting in hindsight, the FDIC guidance on this topic (FDIC FIL 57-2002) struck a hopeful tone, noting that it "recognizes that the institutions it supervises generally adhere to high standards of conduct...[and it] anticipates that it will not be required to take action to correct unfair or deceptive acts or practices on a frequent basis."

This optimism was short-lived. Regulator trust in the industry's ability to self-police took a massive hit in the wake of the "great recession." Many read the post-mortem as a collapse precipitated by the industry's desire to act with speed, efficiency, and a bigger appetite for risk at the sacrifice of underwriting scrutiny and prudence. When the bill came due, the financial services industry was left with the Dodd-Frank Act and the CFPB.

Building on the foundation established by the FTC Act and prior regulator guidance, the Dodd-Frank Act also expressly prohibits any covered person or service provider from engaging in any activity that is considered unfair, deceptive or abusive. Indeed, an entire section of the CFPB Examination Manual is devoted to outlining the CFPB's guidelines to determine if an act or practice is unfair, deceptive, or abusive. Some of this content should be top of mind when reading the Supervisory Highlights. For example, the CFPB notes that a harm may be "substantial" even if the per capita harm is not. In words, a small amount of harm to a large number of consumers is sufficient. And actual injury is not necessarily required. Rather, a significant risk of concrete harm may be sufficient. Similarly, the CFPB also notes, when discussing the ability of a consumer to avoid such injury, that "if almost all market participants engage in a practice, a consumer's incentive to search elsewhere for better terms is reduced, and the practice may not be reasonably avoidable."

This framework makes sense, and conceptually it is not a new conjuring. These principles are found throughout regulatory guidance fashioned piecemeal over time. Moreover, many of the practices outlined in the Supervisory Highlights as "unfair practices" likely would align with a reasonable person's plain language understanding of that term.

Overdraft fees imposed due to delays in the payment processing system? Overcharged late fees caused by improper system settings? Splitting a single missed payment into multiple sub-payments, thus increasing the possibility of multiple returned payments? Accepting, and then reversing, payments made by credit card because such payments are contrary to the creditor's or servicer's policies? None of these actions were requested or "caused" by the consumer. And if you tried to explain any of them to your grandmother, would you feel good about your explanation?

But there may be something else lurking within the Supervisory Highlights and other recent federal guidance: cost justification for the amount of a fee. For example, a portion of the Supervisory Highlights discusses concerns with certain fee assessment practices in the auto servicing space. In particular, a concern is raised regarding auto credit servicers allowing only check and preauthorized ACH as free payment methods to borrowers. Because of these limited choices, the CFPB alleges that roughly 90% of payments made by consumers incurred a "pay-to-pay fee," and that the amounts of these fees "far exceeded the servicers' costs for processing payments, after the consumer was locked into a relationship with a servicer chosen by the [auto] dealer." The criticism is that consumers could not choose who is servicing their account, and were trapped with preferred payment methods (check and ACH) they could not make because they were unbanked.

Several questions are left unanswered from this discussion, however. Precisely what types of payments resulted in the assessment of a "pay-to-pay fee"? And what drove such a high percentage of consumers to incur it? Did the fees result from the use of a particular payment channel - such as by phone or online? Or did they result due to the use of a particular payment method, such as a credit or stored value card, or a money order because the payor was unbanked? And if a central cause was that the consumer was unbanked, does the admonition regarding the spread between the servicer's payment processing cost and the amount of the consumer's fee apply equally in all cases?

This focus on cost may be an extension of prior regulatory guidance. For example, in June of 2022, the CFPB issued an Advisory Opinion regarding debt collector "pay to pay fees." But unlike the fees discussed in the Supervisory Highlights, which appear specific to pre-default servicing, the concern discussed in the Advisory Opinion has a federal statutory and regulatory backbone. Both the Fair Debt Collection Practices Act and CFPB Regulation F make it an unfair practice for a debt collector to collect amounts not "expressly authorized" by the credit document or applicable law. While state law may impose a similar limitation on pre-default servicers, the FDCPA and Reg F generally do not apply in that context.

It may also echo recent efforts of the CFPB to slash the amount of the credit card late fee safe harbor. There too, however, there is a statutory foundation. The Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "Card Act") amended the Truth-in-Lending Act to require that late fees be reasonable and proportional to the violation of the consumer's payment obligation. Reg Z builds off this statutory foundation to permit card issuers to impose a late fee that "represents a reasonable proportion of the total costs incurred by the card issuer as a result of that violation." The credit math behind the proposed safe harbor reduction finds its touchstone in this requirement.

Such a statutory or regulatory basis appears absent from the discussion of the auto loan servicer "pay-to-pay fee" discussed in the Supervisory Highlights. Is this a drafting oversight or a harbinger of things to come? It may be the latter. While guidance from the White House on this issue covers many industries (concert tickets, hotel fees, etc.), a March 21, 2023 blog posts titled "How Junk Fees Distort Competition" highlighted the pricing disparity between the cost for a bank to use FedWire to send or receive wire transfers, and the cost banks often charge a customer for that service. The gap is often significant.

With this in mind, financial service providers may need to look not just across the street to see what the competition is charging for a particular product or service, but also to the cost they bear to provide it. For national banks, at least, this should not be a new concept. Under OCC regulations governing their operations, national banks have the ability to impose non-interest fees and charges subject to their consideration of certain factors. One of those factors is the cost incurred by the bank to provide the service.

We have come a long way from 1980 and the FTC Policy Statement. There, when discussing whether a consumer injury was "avoidable," the FTC stated the general expectation that the marketplace would be self-correcting, with faith placed in "the ability of individual consumers to make their own private purchasing decisions without regulatory intervention...." Those days may be over, and that faith appears to be long gone.

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