

Overview of CFPB's Overdraft Final Rule

On December 12, 2024, the Consumer Financial Protection Bureau finalized a rule that goes beyond the agency's statutory authority and, if allowed to take effect, will lead banks to restrict, if not eliminate, access to overdraft. If not invalidated, the rule would effectively bring an end to overdraft services for millions of consumers who – following receipt of a consumer-tested disclosure – choose to use the product to cover emergency expenses and other liquidity shortfalls, all to advance the prior administration's political campaign against "junk fees."

Summary of the Rule

The final rule applies Truth in Lending Act (TILA) and Regulation Z to overdraft protection services offered by banks and credit unions with assets in excess of \$10 billion (Large Banks) that charge an overdraft fee above a certain dollar threshold. (Despite this attempted line drawing, the final rule will impact financial institutions of all sizes because they will face market pressure to conform their overdraft fee to the rule's cap.)

Congress passed TILA to ensure consumers receive "meaningful disclosure of credit terms," and expressly defined "credit" as "the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment." Overdraft is not "credit" because bank deposit agreements do not give consumers the *right* to have an overdraft transaction paid or to defer payment—the overdrawn amount is due immediately to the bank.

Despite this clear statutory text, the final rule unlawfully creates a new type of "credit" called "overdraft credit" that is subject to TILA/Reg. Z *unless* the bank charges a "true courtesy" overdraft fee using one of the two calculations below:

- **A fee that reflects the institution's "breakeven" costs to operate its overdraft program.**
- **A fee that conforms to a "benchmark" fee of \$5 set by the CFPB.**

Neither calculation, however, fully includes a bank's costs to process overdraft payments, respond to customer questions, and pay for compliance, core provider, and technology expenses.¹ In addition, the CFPB calculated its \$5 benchmark fee using data collected from only five very large financial institutions—data that is unlikely representative of the entire industry. Bankers uniformly state that they will not take on the operational costs and compliance and litigation risks of calculating the bank's breakeven costs. Banks also cannot sustainably offer overdraft services to their customers at \$5 per overdraft.

Compliance with TILA / Regulation Z

If a bank's overdraft fee exceeds either the breakeven or benchmark fee, the final rule requires the following:

- Calculate and disclose the annual percentage rate (APR) of the overdraft "credit."
- Provide account opening disclosures and periodic statements (including rules on the timing of periodic statements).
- Banks would be prohibited from treating the overdrawn amount as a negative balance on the customer's deposit account. Instead, each time a customer overdraws the account, the bank must create a separate "covered overdraft credit account" from which the bank would extend "covered overdraft credit."
- Banks would be prohibited from requiring customers to use a preauthorized electronic funds transfer to repay the overdraft "credit," which increases risk to the bank that an overdraft will not be repaid.

Moreover, if a bank allows a customer to overdraw using a debit card (and the bank's fee exceeds either of the final rule's fee caps), then the bank must follow an *additional* set of disclosure and substantive requirements established by the CARD Act, which were designed to apply to revolving (credit card) credit:

- **Additional disclosure requirements.** The bank would be required to comply with a host of additional disclosure requirements applicable to credit card accounts, including timing requirements for providing

¹ In the final rule, the CFPB increased its initial \$3 benchmark fee calculation to \$5 purportedly to cover compliance, core provider, and technology expenses. However, the CFPB did not explain how it determined that these costs amount to an additional \$2 per overdraft transaction. As stated above, the \$5 fee calculation does not accurately reflect the bank's costs to administer the overdraft service.

disclosures, rate-disclosure requirements, due date disclosure, repayment disclosure, and format requirements for periodic statements.

- **Prohibition on offsets.** When incoming deposits are made to an overdrawn account, the bank is prohibited from using the deposit to pay off the overdrawn balance. Instead, the bank must wait for the customer to repay the outstanding balance, and Reg. Z gives credit card customers at least 21 days to repay the debt. This increases the credit risk of paying an item into overdraft, and customers who use overdraft regularly typically carry higher credit risk.
- **Requirement to assess customer's ability to pay.** The bank would be required to assess the customer's ability to repay the overdrawn amount, using the same underwriting standards they use with traditional credit card customers. This requirement will significantly limit access to overdraft, as many customers who use overdraft do not qualify for a credit product.
- **Submission of overdraft "credit" agreement to CFPB.** The bank would be required to submit its overdraft "credit" agreement to the CFPB on a quarterly basis.
- **Caps on fees.** The bank would face aggregate fee caps (i.e., may not charge overdraft fees during the first year after opening the credit account that amount to more than 25% of the customer's credit limit), limitations on "back-end" penalty fees (such as when the customer makes a late payment or exceeds their credit limit), and requirements for allocating payments in excess of the minimum payment.

Compliance with these provisions will not only add to the compliance and operational complexity, cost, and risk to banks that choose to offer overdraft services, but these requirements will be confusing to consumers. Consumers will receive two statements each month – one under Reg. Z (for the overdraft "credit" feature on their account) and another for the deposit account (in compliance with Reg. DD), further adding to consumers' confusion. Customers value overdraft in part because of its convenience, and this process will be anything but convenient.