MAY 1, 2024

Consumer Financial Protection Bureau Releases Final Rule Limiting Credit Card Late Fees

by Ross M. Speier , Tatum Andres , Hannah Koepke

In March the Consumer Financial Protection Bureau (CFPB) announced a final rule intended to limit late payment fees on consumer credit cards distributed by the larger credit card issuers (the "Final Rule"). The Final Rule, which takes effect on May 14, 2024, marks a pivotal shift in the CFPB's regulation of credit card fees. However, the Final Rule has been met by resistance from banking industry trade groups seeking to enjoin application of the rule prior to its effective date.

Final Rule Overview

The Final Rule modifies a provision of Regulation Z that limits the pricing of late fees for "Larger Card Issuers" (which the CFPB describes as "card issuers that together with their affiliates have one million or more open credit card accounts."). Regulation Z enforces the Truth in Lending Act (TILA), which was revised by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act), overseeing the permissible amounts that credit card issuers can levy for penalty fees, such as late fees.

Previously, Regulation Z provided that credit card issuers could not impose a fee for violating the terms or other requirements of a credit card account (such as a late payment, exceeding the credit limit, or a returned payment), unless the issuer had determined that the dollar amount of the fee represented a reasonable proportion of the total costs incurred by the issuer for that type of violation. Alternatively, credit card issuers could rely on the Regulation Z "safe harbor" fee amounts, permitting issuers to charge up to $30 for the initial late payment and up to $41 for subsequent late payments, with adjustments for inflation on an annual basis.

However, the CFPB had determined that the discretionary safe harbor dollar amounts for late fees were too high and not consistent with the TILA statutory requirement that such fees be reasonable and proportional to the omission or violation to which the fee relates. Thus, the Final Rule reduced the late fee safe harbor amount to $8 for Larger Card Issuers, and also eliminated the increased safe harbor fee amount for subsequent violations. Additionally, the Final Rule provides that the $8 late fee limit will no longer be subject to annual adjustments for inflation with respect to Larger Card Issuers.

Under the Final Rule, Larger Card Issuers must provide concrete evidence justifying any fees above the $8 cap. This requirement is designed to ensure that any additional fees reflect actual costs incurred due to late payments. Thus, if a Larger Card Issuer wants to impose late fees exceeding $8, they must adhere to an alternative to the safe harbor provision in Regulation Z which necessitates pricing the penalty fee

based on an assessment of what constitutes a "reasonable proportion of total cost incurred as a result of the violation," either across all accounts or on a portfolio-by-portfolio basis. This analysis must be conducted annually, and if costs decrease according to the updated analysis, the penalty fee must be lowered accordingly. Additionally, the Final Rule revises the types of costs that can be factored into such analyses. Currently, most consumer credit card issuers opt for Regulation Z's safe harbor provision for pricing penalty fees, as it offers greater regulatory certainty compared to the alternative computation method.

According to the CFPB's press release, by reducing the typical fee from $32 to $8, American families will save more than $10 billion in late fees annually once the Final Rule goes into effect.

For other penalty fees, such as returned payment fees, Larger Card Issuers may utilize a more general safe harbor regime, allowing for significantly higher fee amounts. As updated by the Final Rule to account for inflation, this regime typically permits credit card issuers to charge up to $32 for the initial violation of a consumer's credit card agreement and up to $43 for subsequent violations within the same billing cycle and the following six billing cycles. These amounts remain subject to annual inflation adjustments.

Smaller Card Issuers (defined as a card issuer that together with its affiliates had fewer than one million open credit card accounts for the entire preceding calendar year) can also take advantage of the fee amounts permitted under the general safe harbor regime for any penalty fee type, including late fees, as the Final Rule's reduction of the late fee safe harbor amount and elimination of annual inflation adjustment do not apply to Smaller Card Issuers.

Trade Group Pushback

The CFPB's Final Rule on credit card late fees has been met by resistance from banking industry trade groups. The U.S. Chamber of Commerce, the American Bankers Association, and several other banking industry trade groups filed a brief on April 26, 2024 seeking a preliminary injunction that would block the CFPB's Final Rule.

The trade groups have claimed that if the Fifth Circuit waits until after the May 14 effective date to enjoin the CFPB's Final Rule on credit card late fees, the credit card issuers will face "irreparable harm." According to the trade groups' filing, credit card issuers would be forced to maintain the $8 late fees for at least 45 days before increasing the fee again, as issuers are obligated to provide at least 45 days advance notice to consumers prior to increasing their late fees. This means that if the CFPB's Final Rule goes into effect for even one day, credit card issuers would be obligated to maintain the $8 fee for 45 days and revise all necessary documentation, training, and disclosures to reflect said change, which according to the trade groups "would result in a substantial loss" of revenue. The trade groups argued that the "costly process of designing and printing hundreds of millions of pages of new application,

marketing, and disclosure materials" to emulate the new fees is an enormous burden.

The trade groups further asserted that the "irreparable harm" to credit card issuers would not only be caused by the direct costs of significantly reducing credit card late fees, but the Final Rule would also yield a substantial toll on customer goodwill. Credit card issuers argue they would lose the trust and goodwill of their customers due to the frequent changes in late fees, and that such changes under the Final Rule "will only further confuse consumers and cause issuers to incur unnecessary costs."

The Fifth Circuit has ordered the CFPB to file a response by May 13, 2024. We will continue to monitor these proceedings and any similar efforts to block or curtail the Final Rule.

Guidance for Stakeholders

- **For Credit Card Issuers:** It is crucial to review and revise late fee policies and procedures to ensure compliance with the late fee Final Rule by the May 14, 2024 deadline. Issuers should also prepare to substantiate any fees above the new $8 safe harbor threshold with appropriate cost analyses consistent with the cost analysis provisions in Regulation Z (12 CFR § 1026.52(b)(1)(i)) for determining penalty fee amounts.

- **For Advocates and Legal Professionals:** Given the rapidly approaching effective date of the Final Rule, there is an urgent need to educate credit card issuer clients and other stakeholders impacted by the rule about the changes imposed under the Final Rule, and to provide guidance on how to comply with the new requirements and address potential disputes or misunderstandings on the part of consumers.

Conclusion and Next Steps

The CFPB's Final Rule on credit card late fees represents a significant step by the Bureau in its ongoing attempts to regulate credit card issuers and the terms issuers are permitted to offer their customers. Of course, the CFPB's actions with respect to the Final Rule are not an isolated event, but rather part of a broader ongoing strategy to reform the credit card market. The Final Rule is a direct response to the CARD Act's stated intent to prevent credit card companies from profiting excessively from penalty fees. It also follows a series of enforcement actions against credit card companies for practices deemed to be in violation of consumer finance laws, including charging undisclosed fees and engaging in discriminatory practices.

As the effective date approaches, all parties involved in the credit card industry must prepare for the changes imposed by the Final Rule, including updates to policies and procedures impacting penalty fee pricing, as well as customer-facing disclosures and documentation regarding updates to account terms.

For any inquiries or further clarification regarding the CFPB's Final Rule, and guidance on how to comply prior to the rule's effective date, please contact our Consumer Financial Services team.