Regulators Push to Eliminate "Junk Fees"

Lawmakers and regulators announced plans to eliminate "junk fees" – overdrafts and other charges consumers pay on deposit accounts.

Is your institution charging junk fees? What happens if regulators limit (or even eliminate) the amount you can charge for overdrafts and insufficient fund fees? Does your business model rely on the income generated from these fees?

The Consumer Financial Protection Bureau (CFPB) recently lowered the late fees credit card companies can charge from $32 to $8, which is a pretty sizable cut. Now, they're coming after banks, credit unions, and mortgage lenders.

Can you keep your overdraft program? What happens if this fee income disappears? Read on to find out.

What are junk fees?

First things first: What exactly is a junk fee?

The CFPB's proposed rule on overdrafts and junk fees defines them as fees that don't align with costs. While the CFPB has been leading the charge on eliminating these fees, it's important to note that other agencies aren't fond of them either.

The FDIC, OCC, and NCUA joined the CPPB, arguing that "authorize positive, settlement negative" (APSNs) should be eliminated. ASPNs are fees charged when a consumer's account shows a positive balance at the time of the transaction, but late posting payments push it into the red.

Even though surveys show that consumers desire access to overdraft services, the days of institutions generating revenue from them might be numbered.

While financial institutions of less than $10 billion aren't included in the CFPB's proposed rule, regulators have indicated that they want to curb all revenue from overdrafts, bounced checks, representments (when a consumer incurs multiple overdrafts from a single merchant), and account fund information fees.

And junk fees aren't just about deposit accounts. In March 2024, the CFPB set its sights on mortgage closing costs, claiming that the fees borrowers pay for appraisals, credit reports, etc., artificially inflate the price of homeownership. Mortgage lenders need to watch this situation closely. As the CFPB weighs its options, these lenders should determine if the additional fees they charge homeowners align with costs.

What will happen to my overdraft program?

The CFPB offers two solutions for banks, credit unions, and other lenders when it comes to charging overdrafts and other fees:

- They must prove overdrafts and other fees only cover the costs of their program and are revenue-neutral
- These fees can be set at much lower amounts – the CFPB has suggested overdrafts as low as $3.

Financial institutions and other lenders might begin to meet this regulatory challenge by conducting risk assessments on overdrafts and other fee income. They should calculate the actual costs of mailing statements to consumers, overdraft protection, and other fees to see if they align with what they're charging.

Armed with this information, they can determine if the CFPB's benchmark rates are the best way to go or if they should spend more time cost-calculating.

Are there other options to continue your fee programs?

Financial institutions and other lenders probably won't like the workaround for continuing to charge overdrafts and other fees at the same rate. If banks, credit unions, and mortgage treat these fees as lines of credit, they're in the clear.

Unfortunately, institutions going down this path will be subject to compliance requirements under TILA and the CARD Act. The compliance costs and regulatory burdens these laws impose might exceed the revenue generated from fees.

Is it time to adjust your business model?

Regulators want the banking industry to move toward arrangements beneficial to consumers. In other words, don't be shocked if regulators begin to scrutinize fees at institutions of less than $10 billion.

Megabanks have the luxury of not charging these fees. In 2022, Bank of America reduced overdrafts from $35 to $10 and eliminated insufficient funds fees. These moves by larger commercial banks put pressure on small institutions to do the same. With the new regulatory focus on junk fees, financial institutions should prepare to face even greater challenges in collecting this revenue.

Limitations on fee income may put a strain on budgets. Thankfully, financial institutions and other lenders have time to prepare. So, what should they do?

Should they charge higher interest rates on loan products to offset losses in fee income? Should they focus more resources on growing your deposit base? Easier said than done comes the inevitable reply from smaller institutions.

Cutting costs is an option. With many financial institutions operating on tight budgets, technology delivers efficiencies that reduce spending.

Recent research by a team of finance professors at UCLA suggests the problem and solution for smaller and mid-sized institutions competing with larger industry players. Consumers often bank with larger institutions, even when smaller institutions pay better rates for deposits. They accept this tradeoff because larger banks offer better technology services (fancier mobile banking apps, peer-to-peer lending platforms, etc.).

Smaller financial institutions understand that they need to embrace technology to remain competitive. Lost revenue from overdrafts and other fees will continue to fuel the drive for small and mid-sized institutions to streamline costs and innovate.