Date of Hearing: April 15, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Timothy Grayson, Chair
AB 2017 (Grayson) – As Amended March 18, 2024

SUBJECT: Banks and credit unions: nonsufficient funds fees

SUMMARY: This bill prohibits a bank or credit union subject to the examination authority of the commissioner of the Department of Financial Protection and Innovation (DFPI) from charging a nonsufficient funds (NSF) fee when the consumer's attempt to initiate a transaction is declined instantaneously or near instantaneously by the bank or credit union due to nonsufficient funds.

EXISTING LAW:

Federal Law

Provides the Truth in Lending Act and its implementing regulations, known as Regulation Z, which, among other things, requires lenders to disclose all charges and fees associated with a loan. Reg Z provides an exception for charges imposed by a financial institution for paying items that overdraw an account unless the payment of such items and the imposition of the charge were previously agreed upon in writing. (12 CFR 1026.4)

State Law

1) Includes the following, among others, in the definition of "licensee" under the Financial Institutions Law (Financial Code Section 185):

   a) A bank authorized by the commissioner to conduct business, as specified.

   b) A credit union authorized by the commissioner to conduct business, as specified.

2) Requires a bank or a credit union subject to the examination authority of the commissioner shall report annually, on or before March 1, to the commissioner on the amount of revenue earned from overdraft fees and nonsufficient funds fees collected in the most recently completed calendar year and the percentage of that revenue as a proportion of the net income of the bank or credit union. (Financial Code Section 521)

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) **Purpose.**

   According to the author:

   > In January, the Consumer Financial Protection Bureau (CFPB) proposed a new rule that would prohibit nonsufficient fund (NSF) fees on transactions that are declined instantaneously or near-instantaneously in order to "proactively set regulations to protect consumers from abusive practices." It has been shown that

> these fees are most likely to be assessed on financially vulnerable consumers, increasing financial strain while also negatively affecting a consumer's overall perceptions of the banking system being fair and transparent. AB 2017 will codify CFPB's proposed rule in order to protect consumers and prevent fee creep in California.

2) **Overdraft and NSF fees.**

While overdraft fees and NSF fees are often discussed together, they are separate fees consumers pay in two different situations.

An overdraft fee is charged when a consumer attempts a debit transaction that exceeds their account balance and the financial institution lets the transaction proceed. In essence, overdraft acts as a short-term extension of credit for the customer, with the financial institution covering the transaction rather than halting it altogether. Many banks and credit unions have some type of overdraft program for their customers, though these programs may be structured differently. For example, some banks and credit unions may establish overdraft limits (the amount by which the institution would allow payments to overdraw a consumer’s account) at different or varying amounts or have different fee amounts based on the number of overdraft clearances that occur in a specified time period. The typical overdraft fee today is around $35.

An NSF fee is charged by a financial institution when they decline to make a payment from a consumer’s account after determining the account lacks sufficient funds. In this case, the bank or credit union does not cover this transaction or extend credit (like in overdraft), and the transaction is rejected. The use of NSF fees is far less common than overdraft: According to the CFPB, a majority of large banks with at least $1 billion in total assets have stopped charging NSF fees. And, to the extent this fee is charged, it is typically for a declined personal check or Automated Cleaning House (ACH) transaction and rarely for a declined Automated Teller Machine (ATM) or debit transaction.

Despite their modest use by large banking institutions, the CFPB has been very critical of NSF fees for their lack of clear purpose:

> Consumers receive no service at all in exchange for this fee. Indeed, NSF fees intensify financial distress for consumers, who often are already at their financial edge and who will often also be hit by the fee merchants charge when a consumer’s payment bounces. NSF fees average $34 each, even as any marginal cost to the institution to return a payment is likely exceedingly low.[1]

3) **DFPI report on overdraft fees NSF fees**

In response to growing concerns about the excessive fees charged by banks and credit unions, the Legislature passed SB 1415 (Limón), Chapter 847, Statutes of 2022, to require the DFPI to collect data from state-chartered banks and credit unions about their fee practices. SB 1415 was partly in response to press reports highlighting how smaller banks

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[1] https://www.consumerfinance.gov/about-us/blog/consumers-on-course-to-save-one-billion-in-nsf-fees-annually-but-some-banks-continue-to-charge-them/

and credit unions relied on NSF and overdraft fee revenue more than larger financial institutions. The first report, released in March 2023, contains a number of key takeaways as it relates to AB 2017:

- ***Overdraft and NSF fee revenue is modest for many institutions.*** One immediate takeaway is that more than half of California's banks and credit unions collect minimal revenue from these fees, as measured as a percentage of the institution's net income. Of the 214 institutions that reported information, 114 reported combined NSF and overdraft fee revenue making up less than 5% of their net income

- ***Overdraft and NSF fee revenue is quite significant at a smaller number of institutions***. At the same time, DFPI's report highlights how some institutions still heavily rely on fee revenue. 75 institutions reported combined overdraft and NSF revenue making up more than 10% of net income, 56 of whom reporting fee revenue exceeding 20% of net income.

- ***NSF fees remain common.*** As larger banks have moved away from NSF fees, DFPI's report shows that the vast majority of state-chartered institutions still charge NSF fees in some form. Only 23 banks or credit unions reported zero income from NSF fees.

There are limitations in what we can conclude from DFPI's report. For example, the California Credit Union League (CCUL) has pointed out that measuring fee revenue as a share of net income is an imperfect measure that can end up misrepresenting the relative importance of fees to the credit union's business operations. Even with these caveats, one takeaway is that at least some of California's banks and credit unions have an outsized reliance on NSF and overdraft fees as a source of revenue.

4) **CFPB's "Junk Fee" initiative and proposed rules**

In 2022, the CFPB launched an initiative to eliminate exploitative junk fees charged by banks and other financial services companies. In supporting materials accompanying that announcement, the CFPB points to research showing how back-end fees can obscure the true cost of a product and undermine a competitive market.[2] As part of that initiative, CFPB has also proposed regulations limiting overdraft fees and preventing misuse of NSF fees. Those proposed rules are summarized below:

- ***Proposed overdraft fee rule.***

  In January 2024, the CFPB announced a proposed rule to rein in overdraft fees charged by the largest financial institutions. This rule, applying to depository institutions with total assets of $10 billion or more, would limit overdraft fee levels to be either a "breakeven" amount, measured as the direct costs to the institution for providing the service, or a "benchmark" amount of either $3, $6, $7, or $14.[3]

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[2] https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-launches-initiative-to-save-americans-billions-in-junk-fees/
[3] https://files.consumerfinance.gov/f/documents/cfpb_overdraft-credit-very-large-financial-institutions_fact-sheet_2024-01.pdf

CFPB also allows a financial institution to charge higher amounts than the proposed fee caps, but only if it complies with federal laws covering loans. As the CFPB notes, consumers who incur overdraft fees may have access to cheaper credit sources, and under the rule CFPB would require disclosures under the Truth in Lending Act (TILA) for these more costly "overdraft loans."

The CFPB expects the proposed rule would be effective on October 1, 2025.

- ***Proposed NSF fee rule.***

  After announcing its overdraft fee proposal, in January 2024 the CFPB announced a second proposed rule to prohibit the use of NSF fees for transactions that are "instantaneously" declined. As noted above, NSF fees are rarely charged in circumstances like debit transactions at a point-of-sale system. Rather, NSF fees typically are charged for rejected personal checks or failed ACH transfers, which are electronic fund transfers made between financial institutions and the ACH network for transactions like online bill payments.

  In its proposed rule, the CFPB discusses why NSF fees are rarely charged for rejected debit card purchases or failed ATM transactions. First, the cost of declining these transactions is minor. Second, banks and credit unions may be responding to the Federal Trade Commission's assertion that such fees "could raise significant fairness issues."

  Nevertheless, CFPB has observed instances of customers being charged NSF fees in such cases and believes this is a loophole that can be exploited. And, CFPB argues that as technical advancements increasingly allow instantaneous payments to become ubiquitous, it is prudent policy to proactively set regulations before this type of fee also becomes ubiquitous. To illustrate this point, CFPB Director Rohit Chopra released a statement accompanying the proposed rule, arguing in part that "large banks and their consultants have concocted new junk fees for fake services that cost almost nothing to deliver.[4]"

5) **AB 2017 implements CFPB's NSF fee proposal.**

   AB 2017 codifies CFPB's proposed NSF fee regulations for state-chartered banks and credit unions. As the author argues, these guardrails will help prevent "fee creep," which occurs when companies gradually incorporate new fees into their services even if those fees do not cover legitimate services. Moreover, the author argues that DFPI's report shows how smaller institutions, like the ones subject to DFPI's supervision, tend to rely more on this fee revenue and so a state law is necessary and appropriate. The author's office, in response to comments from CCUL, described below, is interested in fine-tuning the bill's language to help with compliance.

6) **Support**

   AB 2017 is sponsored by the Consumer Federation of California, who argues:

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[4] https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-rule-to-stop-new-junk-fees-on-bank-accounts/

> AB 2017 is simple, straightforward and seems so obvious that it shouldn't even have to be enshrined in law. If your transaction is declined you shouldn't have to additionally pay upwards of $30 (the common amount of NSF charges) for a transaction that didn't even happen.

7) **Opposition**

AB 2017 is opposed by CCUL, who argues it is premature to codify a federal rule that has not yet been finalized:

> On behalf of our approximately 220-member credit unions and their nearly 13 million members, the California Credit Union League (CCUL) must respectfully oppose AB 2017 (Grayson) which would prohibit state-chartered credit unions from charging a member a nonsufficient fund (NSF) fee when a member's attempt to initiate a transaction is declined instantaneously or near instantaneously. While credit unions do not charge these types of fees CCUL is concerned that AB 2017 is premature due to ongoing rule making at the Consumer Financial Protection Bureau (CFPB) and lacks clarity.

CCUL also expresses concerns about the lack of clarity in the bill's definitions:

> The League is also concerned with the lack of definitions in AB 2017, which does not provide a clear path to compliance. The bill does not define near instantaneous nor instantaneous, which might seem like basic terms but in a compliance-based industry our member credit unions need clarity on how to comply. The CFPB proposal also exempts specific transactions which this bill does not.

REGISTERED SUPPORT / OPPOSITION:

Support

Consumer Federation of California (Sponsor)
California Low-income Consumer Coalition
East Bay Community Law Center

Oppose

California Credit Union League

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