Date of Hearing: July 1, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Timothy Grayson, Chair
SB 1075 (Bradford) – As Amended June 24, 2024

SENATE VOTE: 24-7

SUBJECT: Credit unions: overdraft and nonsufficient funds fees

SUMMARY: Limits the amount of overdraft and nonsufficient fund (NSF) fees a credit union may charge to $14 or the amount set by the Consumer Financial Protection Bureau (CFPB), as specified.

Specifically, **this bill**:

1) Defines the following terms:

   a) "Nonsufficient funds fee" means a fee resulting from the initiation of a transaction that exceed the customer's account balance if the customer's credit union declines to make the payment.

   b) "Overdraft fee" means a fee resulting from the processing of a transaction that exceeds a customer's account balance.

   c) "Fee" means a nonsufficient funds fee or an overdraft fee.

2) Prohibits, beginning on January 1, 2026, a state-chartered credit union from charging a fee exceeding $14 or the amount set by the federal CFPB for the fee, whichever is lower.

3) Requires a state-chartered credit union to provide a credit union a notice each time the credit union assesses a fee. The notice must include specified information, such as the date of the transaction, the type of transaction, the amount of overdraft and whether the transaction was declined or processed.

EXISTING 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) Background: Credit Unions

A credit union is a not-for-profit cooperative that accepts deposits, makes loans, and offers a variety of financial services and products to its members. Under state law, a credit union is formed for the purposes of "creating a source of credit for [members] at rates of interest set by the board of directors, and providing an opportunity for them to use and control their own money on a democratic basis in order to improve their economic and social condition."

In many important ways, a credit union functions similarly to a bank and is subject to comparable rules and requirements designed to ensure the safety and soundness of the institution. But, as a cooperative corporation, a credit union is organized and managed much differently than a traditional bank. For example, a credit union is subject to a "field of membership" requirement, meaning that its membership must be limited to groups with a "common bond." This common bond requirement is the reason a credit union may consist of members of a church or labor union, employees of one company, or residents of a defined geographic area.

A credit union also has unique governance because of its nonprofit cooperative structure. A credit union's unpaid board of directors is elected by the credit union's members, who each have a vote regardless of how much money they have held at the credit union. State law also establishes duties and roles for committees and leadership, including the credit committee and the audit committee.

3) Background: 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 transaction and rarely for a declined Automated Teller Machine or debit transaction.

The reliance on overdraft and NSF fees by financial institutions has been heavily critiqued by policymakers and consumer advocates. While overdraft serves a specific purpose that can be beneficial to a consumer, advocates warn that these fees operate "as a back-end profit center that disguises the cost of bank accounts."[1] According to the CFPB, overdraft fees typically affect lower-income households, with 80% of all overdraft fee revenue of large banks coming from just 9% of consumer accounts.[2]

4) DFPI report on overdraft and NSF fees

In 2022, the Legislature passed SB 1415 (Limón), Chapter 847, to require the Department of Financial Protection and Innovation (DFPI) to collect data from state-chartered banks and credit unions about their fee practices. SB 1415 was in response to press reports highlighting how smaller banks and credit unions relied on fee revenue more than their larger counterparts. The first report, released in March 2024, contained a number of key takeaways:

- *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 reported fee revenue exceeding 20% of net income.

5) New scrutiny of credit union fee practices

DFPI's data collection has led to new scrutiny of credit union fee collection practices. An October 2023 Politico opinion article, for example, argues that this new data shows how "many California credit unions are taking millions from their most vulnerable customers and

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[1] https://www.nclc.org/topic/overdraft-fees-and-services/
[2] https://www.consumerfinance.gov/about-us/newsroom/cfpb-research-shows-banks-deep-dependence-on-overdraft-fees/

spending it on perks and bonuses for executives that resemble those of big banks more than nonprofits."[3]

Much of the recent criticism of credit unions has focused on one specific credit union and its treatment of military personnel. An investigative report by KPBS relying on DFPI's data revealed how San Diego-based Frontwave Credit Union, which has an exclusive arrangement with the U.S. Marine Corps and serves around 20,000 Marine recruits, collected $8 million in overdraft fees, triple the average among state-chartered credit unions.[4] This fee revenue ended up becoming vital to Frontwave's business model, with one employee telling KPBS that "we needed that money to survive." In response to the reporting about Frontwave's overdraft practices, a group of federal lawmakers from both political parties issued a letter demanding an explanation for its "exploitative overdraft fees targeting Marine recruits."

Regulators have also voiced concerns about credit union practices. Todd Harper, the Chairman of the Board of the National Credit Union Administration (NCUA), argued in a March 2024 editorial for Credit Union Times that credit unions need to move away from charging overdraft and NSF fees altogether. Harper likens the practice to when Blockbuster Video became overly reliant on late fees, which new competitors like Netflix did not charge. Harper argues that the lesson to learn from Blockbuster is that "profiting from consumers' problems can come back and bite you. That's because, at some point, your competition will solve your customer's problems."[5]

In response to these criticisms, credit unions have pushed back, arguing credit unions face different business pressures than other financial institutions and that overdraft protection is a valuable service to their members. The national group America's Credit Union (ACU) and the California Credit Union League have argued that overdraft protection is a customer service that costs money to provide and that credit union members want. They also argue that banks tend to have access to other revenue sources, which skews the data showing the importance of this fee revenue to a financial institution's bottom line.

Even if the criticism of credit union fee practices fails to account for these nuances, the industry acknowledges certain fee practices will likely need to change. In February 2024, the ACU issued a note to its federally-chartered members that credit unions may rethink overdraft and NSF fee practices in light of how reporting of this information "could affect reputation risk."[6]

6) <u>CFPB's "Junk Fee" initiative and proposed rules</u>

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

[3] https://www.politico.com/news/magazine/2023/10/05/credit-unions-overdraft-fees-00119904
[4] https://www.kpbs.org/news/2024/03/11/oceanside-frontwave-credit-union-millions-fees-young-marines-money
[5] https://www.cutimes.com/2024/03/04/credit-unions-should-rethink-their-overreliance-on-overdraft-nsf-fees/?slreturn=20240613171901
[6] https://www.americascreditunions.org/compliance/ncua-call-report-update-focus-on-overdraft-nsf-fees-penalties-resume/?utm_source=substack&utm_medium=email

announcement, the CFPB points to research showing how back-end fees can obscure the true cost of a product and undermine a competitive market.[7]

As part of the Biden Administration's "junk fee" initiative, the CFPB announced a proposed rule to rein in overdraft fees charged by the largest financial institutions. This rule, applying to depository institutions like credit unions 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.[8]

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 for these more costly "overdraft loans."

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

7) <u>What does SB 1075 do?</u>

SB 1075 limits the amount of an NSF or overdraft fee to $14 or the amount set by the CFPB as part of the proposed regulations described in Comment #6. This cap applies only to credit unions and would take effect on January 1, 2026, after the CFPB rules are finalized. In effect, this bill ensures that CFPB's established fee cap, which would apply only to large institutions, applies to smaller credit unions outside of the scope of CFBP's rule. Moreover, as amended on June 25, 2024, SB 1075 also requires a credit union to send a member a notice each time the credit union assesses a fee. This notice is consistent with industry best practices.

Recent amendments also eliminated a provision that would have allowed for a three-day "grace period" for a customer to repay the amount that triggered the overdraft before being charged a fee. This provision was inspired by an existing practice where a small number of credit unions voluntarily refund or waive an overdraft fee if the customer repays the overdrawn transaction within 24 hours. However, SB 1075's proposal proved controversial and was a source of significant consternation and opposition from CCUL.

8) <u>CCUL position update</u>

Following recent author amends, the CCUL dropped its opposition to SB 1075, noting: "CCUL believes the bill in print strikes the right balance of consumer protection while ensuring credit union members still have the ability to access a service that they desire."

REGISTERED SUPPORT / OPPOSITION:

Support

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

California School Employees Association

Opposition

None on file.

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