Via Electronic Submission

August 1, 2022

Bureau of Consumer Financial Protection
1700 G Street, NW
Washington, DC 20552

Re: Docket No. CFPB–2022–0039
Advance Notice of Proposed Rulemaking, Credit Card Late Fees and Late Payments
(Truth in Lending Act/Regulation Z)

Ladies and Gentlemen:

The American Bankers Association (ABA), Consumer Bankers Association, Credit Union National Association, and National Association of Federally-Insured Credit Unions (collectively, Associations) welcome the opportunity to comment on the Consumer Financial Protection Bureau's (Bureau) Advance Notice of Proposed Rulemaking (ANPR)[1] regarding credit card late fees and late payments. Specifically, the Bureau is reviewing Section 1026.52(b) of Regulation Z (Truth in Lending Act), which implements Section 1665d of the Truth in Lending Act requiring that credit card penalty fees, including late payment fees (late fees), be "reasonable and proportional to [the] omission or violation." Areas of inquiry in the ANPR include factors used by card issuers to set late fee amounts, card issuers' costs and losses associated with late payment, the deterrent effects of late fees, cardholders' late payment behavior, methods used by card issuers to facilitate or encourage timely payments, and card issuers' use of the late fees safe harbor provisions of Regulation Z.

In implementing the Truth in Lending Act's requirement that late fees and certain other fees be "reasonable and proportional" to the violation,[2] Regulation Z currently limits late fees, along with other penalty fees, to the dollar amount that represents a reasonable proportion of the total costs resulting from the violation.[3] As an alternative, the rule offers a safe harbor amount that issuers may charge in the event of late payment.[4] The safe harbor amount, which the Bureau reviews and adjusts annually for inflation, currently allows issuers to charge $30 for the first late payment and $41 for a second late payment in the six billing cycles following the violation.[5]

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[1] 87 Fed. Reg. 38,679 (June 29, 2022).

[2] 15 U.S.C. § 1665d.

[3] 12 C.F.R. § 1026.52(b)(1)(i).

[4] 12 C.F.R. § 1026.52(b)(1)(ii).

[5] *Id.*

Summary

- When set appropriately, late fees encourage consumers to pay on time and develop good financial management habits. However, if late fees are too low, consumers are more likely to pay late and miss payments, leading to lower consumer credit scores, reduced credit access, and higher credit costs.
- Reducing or eliminating the safe harbor could harm consumers. As the Bureau found with previous restrictions on credit card prices, if late fees are not set at an appropriate amount to cover issuers' costs, effectively encourage on-time payments, and mitigate the risks associated with late payments, issuers may have to rebalance the risks to their credit portfolios in other ways. This could include reducing credit lines, tightening standards for new accounts, and raising annual percentage rates (APRs) and fees for all cardholders, including those who pay on time.
- The current safe harbor for late fees should remain in place. Although it does not cover all of the costs associated with late payments and may not be as effective a deterrent against late payments as would a higher fee, the current safe harbor provides legal certainty to issuers, as well as predictability and consistency to consumers.
- Should the Bureau proceed with additional rulemaking, any proposed permitted late fees should account for costs incurred by issuers related to late payments, the deterrent effect of late fees, and the conduct of the cardholder as required under the Truth in Lending Act.
- Any reduction in or elimination of the late fee safe harbor would have a significant adverse impact on a substantial number of financial institutions with less than $750 million in assets. Accordingly, if the Bureau proceeds with rulemaking, it must comply with the Small Business Regulatory Enforcement Fairness Act (SBREFA).

I. When set appropriately, late fees encourage on-time payments and better credit management.

Credit cards provide valuable benefits—including consumption smoothing, convenience, safety and security, fraud protection, credit-building opportunities, and cardholder benefits and rewards—to millions of cardholders across the country. Like many other entities, card issuers depend on their customers paying their bills in a timely manner and assess a fee in the event of a late payment. Late fees are designed to recover at least part of the issuer's costs associated with late payment and also to encourage on-time payments, minimize defaults and delinquencies, and promote good credit management.

In the ANPR, the Bureau asks about the deterrent effects of late fees, including whether the amount of the late fee impacts its effectiveness in encouraging on-time payments. This section addresses those questions, laying out the data and research on how late fees encourage on-time payments in a variety of settings, including the credit card industry.

Late fees are assessed in part to encourage on-time payments as part of a broader strategy to mitigate the risks associated with late payments or nonpayment. This purpose of late fees is widely accepted and used in an array of instances across both private industry and the federal government. In the original 2010 rulemaking that established the late fee safe harbor, the Federal Reserve Board (FRB) acknowledged that that "as a general matter, the imposition of a fee for particular behavior (such as paying late) can reduce the frequency of that behavior."[6]

1.1: Research from multiple sources demonstrates that late fees incentivize on-time payment.

Research from Argus Advisory, a TransUnion Company, demonstrates that there is a threshold which late fees must reach in order to encourage cardholders to pay on time. In a survey of 2,076 credit cardholders, respondents were asked to indicate the late fee levels that would dissuade them from making late payments. The findings are outlined below:

- To deter 80 percent of cardholders from making a late payment, a fee of $68 to $74 would be required.[7]
- To deter a majority of cardholders from making a late payment, a fee of $40 to $46 would be required.
- A late fee of $38 or less has a lower deterrent effect.

The results of this research suggest that the current safe harbor ($30 charge for the first late payment and $41 for a second late payment in the six billing cycles following the violation) likely serves to incentivize on-time payments for at least some cardholders and that, if anything, a late fee slightly higher than the safe harbor amount would encourage even more customers to pay on time.

Academic research, as well as the Bureau's own research, also underscores the ways in which late fees encourage on-time payment.

- Bureau researchers in 2018 examined consumer behavior in the credit card market and how late fees affect decision-making processes. They found that consumers internalize late fees and factor them into decisions around card payments, in contrast with the theory that penalty fees are "hidden" from consumers. The presence and incurrence of late fees encourage consumers to pay on time. Furthermore, lower fees lead to higher instances of late payments.[8]
- Late fees are often used in other industries, and, similar to the card market, higher fees are more effective at encouraging on-time payments. Haselhuhn et al. found similar effects in the video rental market. Results showed that payment of a late fee decreases the likelihood of late payment the next month by nearly 9 percent, and the deterrent effect of late fees increases with the size of the

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[6] Federal Reserve Board, Truth in Lending Proposed Rule, 75 Fed. Reg. 12,333, 12342 (Mar. 15, 2010).

[7] Argus Advisory, a TransUnion Company (2010). This survey was conducted in 2010, and these values are adjusted for inflation based on the Consumer Price Index.

[8] Grodzicki et al., "Consumer Demand for Credit Card Services," *Consumer Financial Protection Bureau, Office of Research Working Paper No. 2018-03* (2018).

penalty. Furthermore, the deterrent effect of charging a fee is stronger than that of simply providing information to consumers.[9]

- In another study, Fishman and Pope found that paying a late fee reduces the likelihood that the next payment will be late by 19 percent. They also found that these effects decrease the farther out from the initial payment the customer gets. Recency is an important factor in ensuring that payments are made on time; deterrence effects increase with the size and recency of the event.[10] While the video rental market is now obsolete, the observations around consumer conduct hold.
- The Internal Revenue Service (IRS) imposes penalties on those who file their taxes late or do not pay in full. Taxpayers who do not file their returns by the due date usually pay 5 percent of any unpaid taxes for each month or part of a month that a return is late, not to exceed 25 percent of unpaid taxes.[11]

1.2: Reducing or eliminating the safe harbor would lead to more late and missing payments and harm consumers' credit.

If late fees were reduced to an amount that no longer provides a meaningful incentive to pay on time, more consumers would likely pay late. This would diminish issuers' ability to distinguish between creditworthy consumers who happen to pay late accidentally and those who may pose serious credit risks. For consumers, an increase in late payments could lead to a greater risk of default, higher interest rates, and lower credit scores, which lead to reduced consumer credit opportunities and higher costs for credit.

Payment history is the most heavily weighted input of both FICO and Vantage credit scores.[12] Consumers with lower credit scores are less likely to be approved for credit—including non-credit card loans such as mortgage or car loans—and tend to face higher interest rates if they are approved. Making timely payments may also help cardholders avoid becoming overleveraged and overwhelmed as their balance increases.

Some may argue that the threat of a negative credit score impact is enough to incentivize consumers to pay on time. However, academic research demonstrates that the timing of consequences for late payments matters.[13] Consumers are more likely to adjust their behavior when confronted with a short-term penalty close to the time of the late payment, instead of a longer-term consequence. Credit report impacts, while important, can take weeks or months to appear following a delinquency, and consumers generally do not know the mechanics and exact timing of reporting late payments in order to time payments and avoid being reported. Further, many consumers do not check their credit reports

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[9] Haselhuhn et al., "The Impact of Personal Experience on Behavior: Evidence from Video-Rental Fines," *Management Science, Vol. 58, No. 1* (2012).

[10] Fishman and Pope, "Punishment-Induced Deterrence: Evidence from the Video-Rental Market," *University of California, Berkeley, Department of Economics* (2006).

[11] IRS, Failure to File Penalty (2022).

[12] *See* FICO, "What's In My FICO Scores?" (2022); FICO, "What is Payment History?" (2022); and Nerd Wallet (2022), "What is a VantageScore?" (2022).

[13] Fishman and Pope, "Punishment-Induced Deterrence: Evidence from the Video-Rental Market," *University of California, Berkeley, Department of Economics* (2006).

frequently. It is possible that many delinquent cardholders would not notice the impact on their credit score until they were denied a future loan.

In Q4 2021, only about 3.2 percent of credit card accounts were charged a late payment fee.[14] Some may claim that the low incidence of late payments in the credit card market demonstrates that late fees are unnecessary. On the contrary, the low incidence of late payments is a sign that late fees are serving as an effective deterrent for the majority of cardholders. That a small percentage of people repeatedly pay late fees does not mean that late fees are generally ineffective or unnecessary for on-time payment. It only indicates that that group has challenges that are different from those who pay on time.

II. Issuers use a variety of tools to help consumers avoid late payments.

Consumers are repeatedly informed about credit card late fees, and that awareness promotes responsible repayment behavior. Late fees are communicated clearly, conspicuously and often, in marketing, account opening disclosures, and on statements, consistent with their purpose of incentivizing positive payment behavior. Accordingly, the Associations strongly disagree with the premise that late fees are unfair or improperly assessed as described in the ANPR and other Bureau actions, such as the Bureau's earlier Request for Information on consumer fees (Fees RFI).[15]

The credit card industry has been disclosing late fees and other important terms in an easy-to-find and easy-to-read "Schumer box" since 1989 to help consumers compare credit cards. Customers receive the Schumer box with credit card solicitations, and again when they open an account or receive the credit card.[16] Late fee disclosures continue after the account is opened. Under Regulation Z, late fees must be highlighted under a separate "Fees" heading in any month one is imposed and also under a special heading showing the total fees imposed year to date.[17]

2.1: Issuers use many innovative mechanisms to encourage on-time payments.

Issuers want customers to pay on time, and they promote on-time payments through a variety of means in addition to late fees, including multiple payment reminders sent via mail, email, and/or text notification depending on consumer preference. In conversations with ABA, one issuer reported how its new alert system succeeded in helping customers avoid late fees. As of five months after the new alert rollout, gross monthly late fees were 20 percent lower and the late fee incidence rate per balance had fallen by nearly 25 percent.

Issuers also offer and encourage features such as autopay to help customers pay on time. While many customers embrace this feature, others prefer to select the amount and timing of their payment each month. Autopay, thus, may not be suitable for all cardholders, including those with irregular or unpredictable income, such as gig economy workers. Additionally, some cardholders may choose not to

[14] Argus Advisory, a TransUnion Company (2022).

[15] 87 Fed. Reg. 5,801 (Feb. 2, 2022).

[16] *See* 12 C.F.R. §§ 1026.60 (applications and solicitations) and 1026.6 (account opening disclosures).

[17] 12 C.F.R. § 1026.7(b)(6)(iii).

use autopay to avoid accidental overdrafts and returned payments, for example, if there are insufficient funds in the checking account on the day of the automatic payment. While autopay is a useful tool for many cardholders to help them prevent late payments, it is not suitable for everyone and is not a substitute for late fees to help manage portfolio risk.

Another tool issuers offer to help customers pay on time is the ability to choose the payment due date, which allows customers to plan around their own paydays and schedules. Issuers also allow customers to pay by phone or digitally with immediate crediting to their account.

While these consumer-friendly tools are useful for many cardholders to help them prevent late payments, they are not a substitute for late fees in promoting on-time payment or managing portfolio risk.

2.2: Issuers often waive late fees.

Issuers also often waive late fees, where appropriate. Several issuers reported that they forgive the first late fee and often forgive late fees when customers call in. Another issuer offers cards that automatically waive the first late fee, and another issuer reported that it does not assess late fees if the balance is less than $50. Another issuer forgives the fee if at least 90 percent of the minimum payment has been paid. Other issuers implement “grace periods” and do not impose a late fee if the payment is only a few days late.

In addition, issuers offer hardship programs for customers who have experienced a difficult life event. During the COVID-19 pandemic, for example, issuers implemented a series of customer-friendly enhancements to limit late fee assessments.[18] In 2020, one issuer reported that two rounds of relief suppressed fees for 1.8 million card customers. Issuers also reported providing credit education to teach customers how paying on time can help build a good credit history.

III. Increased late fee restrictions would have significant negative effects on consumers, small issuers, and competition in the credit card market.

A reduction in or elimination of the late fee safe harbor could lead to unintended consequences for consumers, including increased credit costs, lower credit availability, and negative credit score impacts, especially cardholders with subprime credit scores (i.e., those who are new to credit or who have had credit challenges in the past).

Many card issuers set late fees based on the current safe harbor amount to recover most costs, encourage timely payment, and avoid the costs of individual issuer analysis while ensuring compliance with the law. A regulation that eliminates the safe harbor or establishes one that does not fully take into account costs, deterrence value, and other factors Congress required the Bureau to consider could push issuers to set fees that do not adequately recover costs and effectively encourage on-time payments. Though late fees could be lower, the costs of late payments would remain (or potentially increase, if the

[18] *See* CFPB, The Consumer Credit Card Market (2021).

deterrence effect of late fees were diminished) and issuers would have to use other measures to recoup their costs.

3.1: Reducing or eliminating the safe harbor would reduce credit access and increase the cost of credit.

Issuers are not eager to cut services, reduce credit, or increase prices. However, for a card issuer business to be sustainable and financially sound (and in compliance with safety and soundness regulations), it must recover costs and manage risk. If the safe harbor were reduced or eliminated, cost-recovery and risk-management mechanisms could include:

- **Limiting of credit access through tightened underwriting standards and reduced credit lines.** Tighter underwriting standards and lower credit lines for new customers would have the greatest impact on those who do not have an established or strong credit history. Without the lever of late fees to mitigate the risk of late payment, issuers may need to be more conservative about approving credit cards for those in this group. Issuers could also reduce credit lines for existing accounts to mitigate risk, an issue about which the Bureau recently expressed concern.[19]

  Credit card access is vital for the financial health and stability of many families. Many cardholders—especially those with lower or irregular incomes—depend on credit cards to help pay for everyday expenses. According to the Census Bureau's Household Pulse Survey, more than 3-in-10 consumers relied on credit cards and other loans to pay usual household expenses in June 2022.[20] If these consumers lost access to credit, they would need to spend less on items like food, fuel, and healthcare, borrow from family or friends (if available), or turn to more expensive, riskier forms of credit (e.g., payday lenders, pawn shops, or illegal loan sharks).[21] Particularly during a period of high inflation and economic uncertainty, it is vital that consumers have access to credit to pay for essential goods and services.

  Consumers also use credit cards to build credit histories that help them qualify for other loans, such as auto loans or mortgages. With tighter underwriting standards, consumers with thin or marred credit files may face more difficulty building or rebuilding credit, potentially increasing the population of "credit invisibles."[22] Finally, some of these consequences have been borne out following implementation of other regulations. Per the Bureau's findings, after limitations set by the Credit Card Accountability Responsibility and Disclosure (CARD) Act, credit access diminished for younger customers and those with subprime credit.[23]

- **Higher credit card APRs, including for lower-risk accounts.** Academic research underscores the manner in which issuers use interest rates and late fees in tandem as part of a broader risk

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[19] *See* CFPB, Credit Card Line Decreases (2022).

[20] Census Bureau, Household Pulse Survey, Week 46, Spending Table 1 (2022).

[21] Following an interest rate cap in Chile, for example, consumers who lost access to credit were more likely to reduce spending on education, healthcare, and other essentials and more likely to fall behind on health bills, rent, and mortgage payments. *See* Cuesta, J. and Sepúlveda, A., Price Regulation in Credit Markets: A Trade-off between Consumer Protection and Credit Access (2019).

[22] *See* CFPB, Data Point: Credit Invisibles (2015).

[23] CFPB, CARD Act Report, at 6 (2013).

management strategy. For example, a 2011 study looked at how firms determine the level of late fees and other credit card penalties, and found that late fees and APRs are used similarly to manage risks and costs across cardholders. The study's findings support the notion that decreases or limits on late fees would result in increases in credit card interest rates.[24]

While rate increases would primarily affect the riskiest consumers, to mitigate the increased risk, interest rates may increase for cardholders of all risk levels, including those who never pay late. Without effective late fees, the cost of late payments would be spread across all cardholders, not just those who make the late payments. In other words, those who pay on time would subsidize those who do not. In fact, after other restrictions were imposed on the credit card industry's risk management practices, the cost of credit went up for all cardholders. As the Bureau has pointed out, in anticipation of CARD Act regulations, retail APRs increased for all customers as those who manage credit well were forced to take on some of the costs associated with riskier cardholders.[25]

A shift from late fees to higher APRs would also shift the cost burden of credit cards further to revolvers (those who carry a balance from month to month), as higher interest rates affect only those who carry a balance.

- **Increases in other fees.** Other fees could also rise, much as checking account fees rose sharply in response to a federal law limiting debit card interchange fee.[26] For example, annual fees, which currently are imposed primarily on higher-end rewards cards, could become more common for other cards.
- **Reduction in popular consumer products.** Rewards and cash back cards, which are extremely popular among consumers of all income levels,[27] may be pared back in order to recover some of the costs associated with late payments. Sign-on bonuses could also be lowered or removed. Issuers may also need to remove or shorten the length of popular introductory APR programs, and consumers may find it more difficult to refinance credit card debt or qualify for cash advance programs.

The increased costs and reduced credit access likely to flow from a reduction in or elimination of the safe harbor would have the greatest impact on consumers with subprime credit. As the Bureau itself points out in its report on late fees, there is a strong correlation between an issuer's risk mitigation through late fees and its concentration of subprime accounts.[28] If issuers lower the fees for risk-related services, such as late payments, they may no longer be able to serve riskier customers who use those services more frequently.

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[24] Massoud et al., "The cost of being late? The case of credit card penalty fees," *Journal of Financial Stability* (2011).

[25] Between Q1 2009 and Q1 2010, the average retail APR for current accounts rose by 230 basis points. CFPB, CARD Act Report, at 31 (2013).

[26] *See, e.g.*, Mukharlyamov, V. and Sarin, N., The Impact of the Durbin Amendment on Banks, Merchants, and Consumers, *Faculty Scholarship at Penn Law*, 2046 (2019).

[27] *See* ABA, *The Benefits of Credit Card Rewards: How Rewards Provide Value to Merchants and Consumers of All Incomes* (2021).

[28] CFPB, Credit Card Late Fees, at 13 (2022).

Additionally, due to expanded credit opportunities, late fees make up a larger proportion of total consumer fees among private label cards than general purpose cards (91 percent compared to 45 percent). Private label card issuers tend to also incur more risk through late payments.[29] A reduction in private label cards would also disproportionately affect cardholders with subprime and prime credit, as well as revolvers, who are more likely to qualify for and use these cards.[30]

3.2: Small issuers in particular would have more difficulty absorbing the costs and may exit the business.

Some smaller institutions have relayed to ABA that they may withdraw from the credit card market or curtail offerings if the safe harbor were reduced or eliminated. As Director Chopra himself has pointed out, "[U]nnecessarily complex guidance and rules impede consumer protection, and instead simply increases compliance costs, which benefits larger market players and their high-priced lawyers. Unnecessary complexity places new entrants and small firms at a disadvantage compared to their larger competitors."[31]

A reduction in or elimination of the safe harbor would compel issuers to conduct a "reasonable and proportional" analysis of their fees on an annual basis. The costs associated with conducting and defending that analysis would have a larger impact on smaller banks as they may lack the necessary resources for such a complex and somewhat subjective determination. In addition, while some may utilize the safe harbor if lowered, a lower safe harbor would also provide a weaker or nonexistent deterrence effect, likely resulting in a greater share of late-paying and delinquent accounts. This, in turn, could necessitate increased collection and other costs for small banks, the reasons several smaller banks informed ABA that they would consider discontinuing their credit card programs if the safe harbor were reduced or eliminated.

Moreover, while raising APRs would be an option for large issuers, some smaller card issuers may not be able to raise rates due to state laws capping interest rates.[32] Without the ability to raise rates, some small issuers have indicated to ABA that they may have to exit the card business altogether, reducing the number of credit card competitors.

Other risk controls that some small issuers have said they would consider include cutting off access to a credit card in the event of late payments. Small issuers also indicated that they would consider using penalty APRs, which many issuers eliminated following enactment of the CARD Act.

3.3: Reducing or eliminating the safe harbor would reduce competition and innovation in the credit card market, leaving consumers with fewer choices and less competitive terms and services.

Substantive regulations targeting fees would discourage innovation, deter market entry, increase consumers' costs across products and services, and reduce overall access to banking. The Bureau is charged with reducing unwarranted regulatory burdens and facilitating innovation in markets for

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[29] *Id.*

[30] CFPB, The Consumer Credit Card Market, at 26, 35 (2021).

[31] CFPB, Rethinking the Approach to Regulations (2022).

[32] If an issuer's rate is close to the interest rate cap of the state where it is located, the issuer would not have the option of increasing interest rates to recoup the costs associated with reduced late fees.

consumer financial products and services.[33] Yet, new substantive regulations targeting late fees would *increase* already significant regulatory burdens and *discourage* innovation and market entry. When issuers must divert resources away from research, development, and product testing in order to comply with costly regulations, they may be forced to provide fewer, less innovative or lower-quality offerings to consumers.

These compliance burdens fall especially hard on smaller institutions. Indeed, increased costs of regulatory compliance can deter market entry by newer or smaller banks and credit unions, who already face steep start-up costs to establish comprehensive regulatory compliance programs. The Bureau should adhere to the sentiments laid out in a recent blog post and "issue guidance in a manner that strengthens the compliance posture of all market participants, not just those with the most market power or resources."[34]

IV. Late fees help to offset the costs and risks imposed by late payments.

Some Bureau statements have incorrectly characterized late fees as major revenue drivers.[35] In fact, the primary purpose of late fees is to help cover the costs associated with late payments. These direct costs include customer service representatives (salaries, benefits, training, etc.) who speak directly to customers, as well as technologies including customer notifications and alerts (both paper and electronic). Late fees also help offset the risk that late payments pose to issuers, including increased volatility of risk outcomes (which make it more difficult to model losses and honor payment obligations to third-party investors) and increased charge-offs. A study by Argus Advisory based on data from 10 large credit card issuers, found that:

- To recover a conservative estimate of the average costs of late payments, late fees would need to be set at approximately $38. These costs included those specifically associated with collections, the proportional share of operating expenses, and the opportunity cost for the loss of the use of funds that were not repaid.[36] This estimate does not include the related unrecovered losses.
- If unrecovered losses were also included as a component of the costs attributable to late payments, a late fee of about $44 would be required to fully offset the costs.

4.1: Card issuers charge late fees in part to mitigate the risks of delinquency and nonpayment.

In addition to recouping costs, issuers also charge late fees to help manage the risks of delinquency and default. The effective management of credit risk is critical not only to the long-term success of individual

[33] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1021(b), 124 Stat. 1376, 1980 (2010).

[34] CFPB, Rethinking the Approach to Regulations (2022).

[35] For example, in the Fees RFI, the Bureau listed examples of annual fees, account maintenance fees, and late fees, claiming that "substantial amount of the revenue earned by financial services companies comes from" these fees, when in fact these three types of fees provide a minimal share of the industry's revenue. *See* 87 Fed. Reg. 5,801 and ABA comment letter thereon.

[36] Argus Advisory, a TransUnion Company (2010). This survey was conducted in 2010, and these values are adjusted for inflation based on the Consumer Price Index.

financial institutions and the banking industry as a whole, but also to consumers, as demonstrated during the 2008 financial crisis. To promote a safe and sound banking system and consumer management of finances, credit card issuers utilize late fees to cover the costs and risks associated with late payments and to encourage timely payment habits. Cardholders who pay late present a significant credit risk, and late fees help issuers manage this risk.

Research demonstrates that cardholders who pay late are more likely to fall into delinquency or default than those who pay on time. A 2011 study of credit card late fees found that card penalties are positively associated with default rate.[37] This finding aligns with 2008 research the FRB cited in its 2010 proposed rule, which also found that late payments are positively correlated with losses. Per this research, 7 percent of accounts that were over the credit limit or delinquent twice in a 12-month period charged off. While nominally a small share of accounts, this nonetheless represents *more than double* the charge-off rate for consumers who did not have such violations during the same period.[38]

V. Late fees reflect late payments, which are associated with higher credit risk, not race or income.

In its report on late fees, the Bureau asserted that late fees disproportionately affect Black cardholders and those with lower incomes[39]; however, based on data from Argus Advisory, the observed correlation between income or race and propensity to pay late fees is almost fully explained by the individual's credit risk. For cardholders with super-prime credit scores, for example, income has no bearing on the likelihood of being charged a late fee. Across all income categories, about 4.8 percent of cardholders with credit scores above 760 were assessed a late fee in Q4 2021 (see Figure 1). Further, half of all late fees are paid by those with annual incomes greater than $100,000.[40]

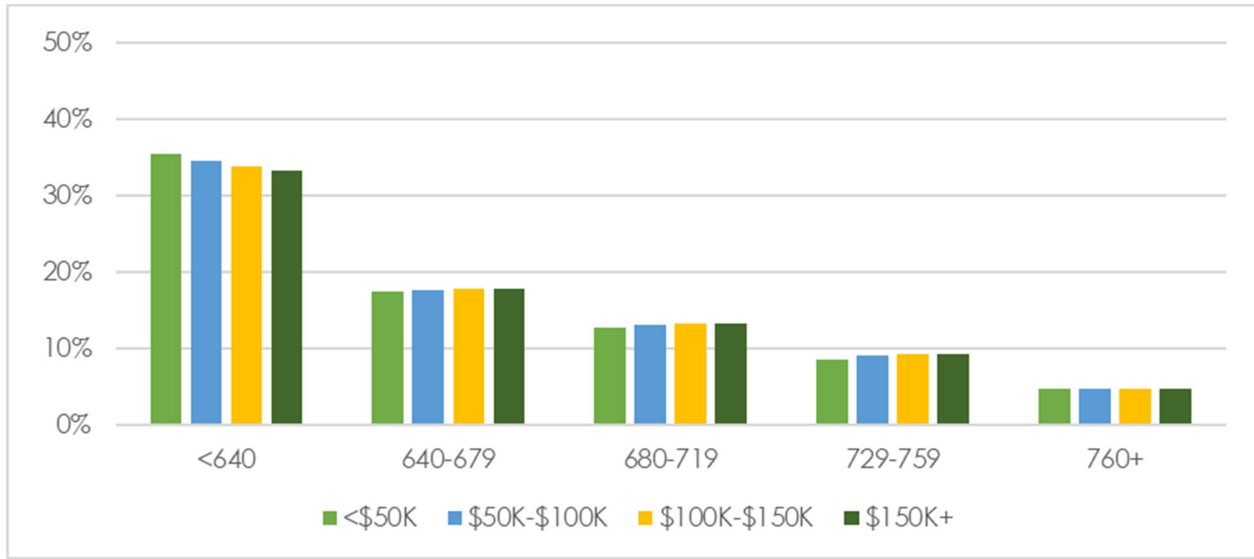
[37] Massoud et al., "The cost of being late? The case of credit card penalty fees," *Journal of Financial Stability*. (2011).

[38] FRB Docket No. R-1314: Exhibit 5, Table 1a to Comment from Oliver I. Ireland, Morrison Foerster LLP (Aug. 7, 2008), which presents the results of a 2008 analysis by Argus Advisory.

[39] CFPB, Credit Card Late Fees, at 10. (2022)

[40] Argus Advisory, a TransUnion Company (2022). In the Argus Advisory analysis, credit scores less than 640 are considered subprime, 640–760 are considered prime, and 760 and above are considered super-prime. It should be noted that cardholders with subprime credit do not necessarily have low incomes. According to Argus Advisory data, the correlation between risk score and income is 0.16 among credit cardholders, a positive but very weak association. A 2018 research note from the Federal Reserve found a similarly weak relationship between risk score and income, identifying a correlation of 0.27 among a broader population of U.S. consumers. *See* Rachael Beer, Felicia Ionescu, and Geng Li, "Are Income and Credit Scores Highly Correlated?" *Board of Governors of the Federal Reserve, FEDS Notes* (2018).

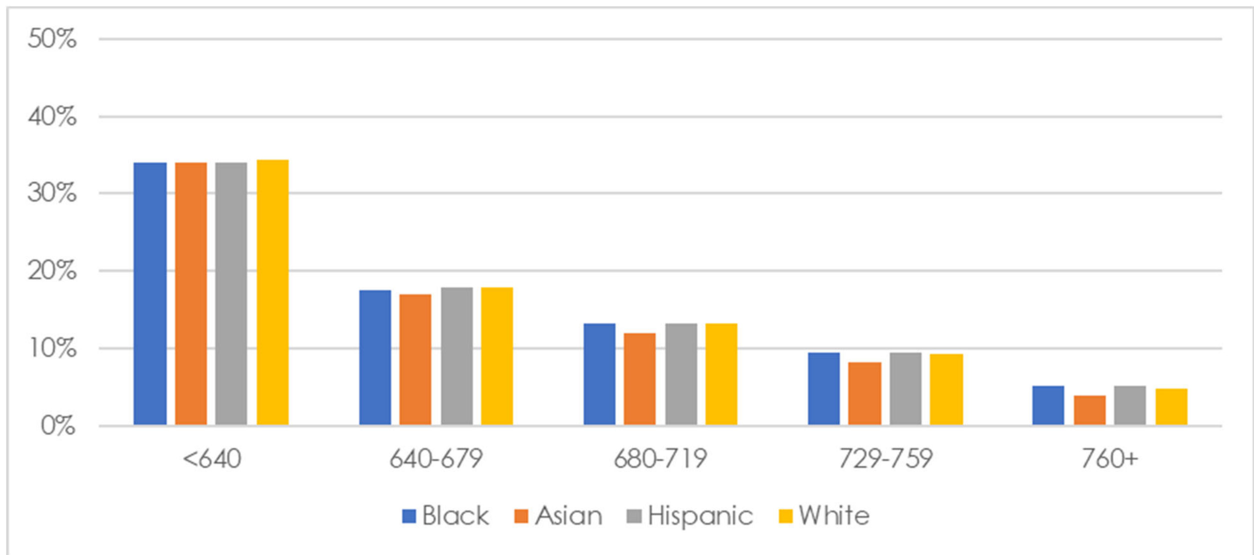
Figure 1: Late Fee Incidence by Income and Risk Score, Q4 2021



Source: Argus Advisory, a TransUnion Company

When controlling for credit risk score, Black cardholders are no more likely to incur a late fee than cardholders of other racial or ethnic backgrounds (see Figure 2).[41]

Figure 2: Late Fee Incidence by Race/Ethnicity and Risk Score, Q4 2021



Source: Argus Advisory, a TransUnion Company

By definition, cardholders with higher risk profiles are more likely to make late payments or not pay at all. Paying late, especially on a repeat basis, is a reliable indicator of increased risk of delinquency and charge-off. In fact, as mentioned above, payment history makes up the largest share in determination of

[41] Argus Advisory, a TransUnion Company (2022).

credit risk scores.[42] If cardholders with subprime credit are making a disproportionate share of late payments, this is simply an indication that risk scores are accurately predicting late payment behavior.

VI. The similarity of late fees across issuers is due to the regulation, not anticompetitive behavior.

The Bureau's interpretation that the similarity of late fee amounts across issuers is evidence of non-competitive behavior is incorrect.[43] Rather than a signal of anticompetitive behavior, the similarity of late fees across issuers is a predictable response to legal certainty granted under the law. As described earlier, the safe harbor allows issuers to recover some (though not all) of the costs associated with late payments, and, though not optimal, also encourages on-time payments.[44] Further, using the safe harbor late fee amount provides compliance certainty without having to conduct and defend an analysis of the fee every year while covering a substantial share of the costs incurred and providing some deterrent value.

Additionally, a closer look at the many variations in account agreements shows that issuers charge different fee amounts under varying fee structures in response to competitive pressures in the card market. As the Bureau finds in its late fee report, "the most common maximum late fee charged in agreements submitted to the CFPB was $25," lower than the safe harbor amount.[45] Some banks also charge fees according to a sliding scale based on the number of times a consumer misses a payment, a reflection of their higher credit risk. Finally, as the Bureau notes in its late fee report, at least one issuer brought new competition into the market with the introduction of cards with zero late fees.[46]

6.1: Credit card issuers are part of a competitive industry.

In his prepared remarks released with this ANPR, Director Chopra twice mentioned the Bureau's goal of promoting a competitive credit card market.[47] While the Associations share Director Chopra's view that healthy competition in the credit card industry is critical and benefits consumers, we strongly disagree with any contention that the current state of competition in the credit card industry is less than robust.

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[42] *See* FICO, "What's In My FICO Scores?" (2022); FICO, "What is Payment History?" (2022); and Nerd Wallet (2022), "What is a VantageScore?" (2022).

[43] A recent blog post by the Bureau also asserts, without substantiation, that many credit card fees "'herd' around common amounts, suggesting that competition is ineffective in driving down price." *See* CFPB, Americans pay $120 billion in credit card interest and fees each year (2022).

[44] Argus Advisory, a TransUnion Company (2010). This survey was conducted in 2010, and these values are adjusted for inflation based on the Consumer Price Index. Due to the short comment period for this ANPR, there was not enough time to repeat this study. However, ABA is confident that the results (adjusted for inflation) still hold.

[45] CFPB, Credit Card Late Fees, at 16 (2022). Late payment fees are capped under certain state laws, and credit card programs governed by these states' laws would be subject to late payment fee caps below the safe harbor amount.

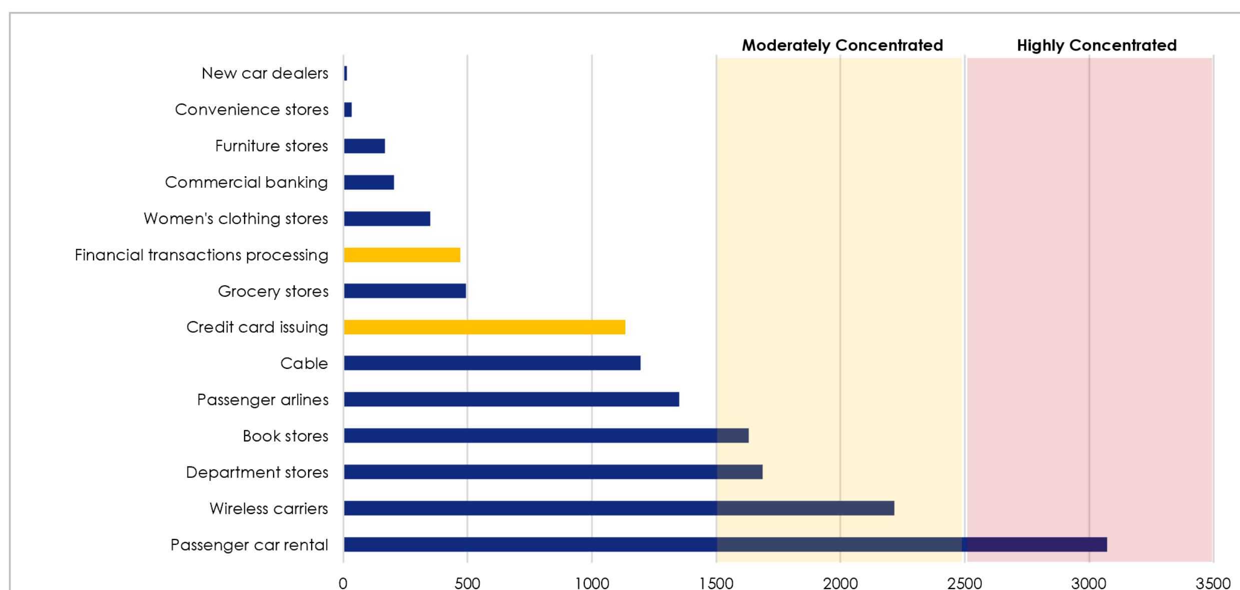
[46] CFPB, Credit Card Late Fees, at 16 (2022).

[47] CFPB, Prepared Remarks of Director Chopra on Credit Card Late Fees ANPR Press Call (2022).

Commonly accepted measurements of industry concentration demonstrate that the U.S. credit card sector is not considered even moderately concentrated, especially when compared to other consumer-facing industries.[48] As shown in Figure 2 below, neither the "Credit Card Issuing" industry nor the "Financial Transactions Processing" industry (which includes credit card and financial transaction processing along with electronic financial payment and funds transfer services) meets the Department of Justice's (DOJ) threshold for a concentrated market. Indeed, several other industries that rely heavily on consumer credit card payments (e.g., passenger car rentals, wireless carriers, department stores or bookstores) are significantly more concentrated.

Credit card companies compete aggressively and constantly on terms, fees, and ancillary products and features that ultimately benefit consumers at all income levels.[49] As the Bureau's own reports have highlighted, the highly competitive market for consumer credit cards has produced a number of innovative new offerings in recent years, such as new types of secured credit cards for less creditworthy borrowers, fixed-payment features, "buy now, pay later" point-of-sale credit products, virtual cards, and new forms of rewards redemptions.[50] And new fintech and big tech entrants are spurring even more competition, digitization, and innovation in the credit card market.[51]

Figure 3: The Herfindahl-Hirschman Market Concentration Index, 2017



Source: Census Bureau

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[48] The DOJ and the Federal Trade Commission use the Herfindahl-Hirschman Market Concentration Index (HHI) to analyze market concentration. DOJ, Herfindahl-Hirschman Index (2018). This is the latest data available.

[49] *See* ABA, *The Benefits of Credit Card Rewards: How Rewards Provide Value to Merchants and Consumers of All Incomes* (2021).

[50] *See* CFPB, The Consumer Credit Card Market, at 168–69 ("Card issuers and other financial services companies continue to innovate in ways that aim to attract or serve consumers.").

[51] *See, e.g.*, Cameron Costa, *The Newest FinTech Unicorn Is a Credit Card, and It's Betting Against Big Banks*, CNBC (2020).

VII. The current safe harbor for late fees should remain in place. If the regulation is amended, permissible fees should, as the Truth in Lending Act requires, reflect costs as well as the fee's impact on incentivizing on-time payments and consumer conduct.

7.1 The current safe harbor should be retained.

As noted, the current regulation limits late fees, along with other penalty fees, to the dollar amount that represents a reasonable proportion of the total costs resulting from the violation.[52] As an alternative, the rule offers a safe harbor late fee amount that issuers may charge in the event of late payment. Pursuant to the regulation, the Bureau reviews and adjusts the safe harbor amount annually for inflation.[53]

The current safe harbor is generally serving the purposes outlined in the regulation:

- First, evidence indicates that the current safe harbor is about *20 percent lower than the costs associated with late payments*: according to an analysis from Argus Advisory, the average late fee amount required to recover a conservative estimate of the average cost of a late payment is $38.67—$8.67 more than the $30 safe harbor.[54]
- Second, Congress requires the Bureau to consider the deterrence effect in implementing the late fee rule. The current safe harbor is lower than the level that provides a meaningful deterrence to paying late; per the Argus Advisory analysis, a late fee charge of $40 to $46 is required to incentivize a majority of cardholders to make on-time payments.[55]
- Third, the safe harbor was designed in part to "increase consistency and predictability for consumers,"[56] and the current regulation accomplishes this goal. Asking issuers to reevaluate the reasonable and proportional level every 12 months could lead to unpredictable, frequently shifting fees for consumers.[57]
- Finally, the regular inflation adjustment to the safe harbor is appropriate. Many of the regulations implemented by the Bureau contain amounts adjusted for inflation, including Regulation Z. Other federal government agencies also adjust fees, benefits, and taxes for inflation, including the IRS, the Social Security Administration, and the Department of Agriculture (which administers the Supplemental Nutrition Assistance Program).

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[52] 12 C.F.R. § 1026.52(b)(1)(i).

[53] 12 C.F.R. § 1026.52(b)(1)(ii).

[54] Argus Advisory, a TransUnion Company (2010). This survey was conducted in 2010, and these values are adjusted for inflation based on the Consumer Price Index.

[55] *Id.*

[56] 75 Fed. Reg. 12,333, 12,345.

[57] *See* 12 C.F.R. § 1026.52(b)(1)(i).

While the industry did not agree with all aspects of the FRB's late fee rule,[58] the safe harbor amount was set in a manner that reflected a good faith attempt to quantify the "reasonable and proportional" to the violation requirement. Although the safe harbor amount does not cover all the costs associated with late payments and is not as effective a deterrent as a higher fee would be, it covers a significant portion of issuer costs, offers encouragement to pay on time, and provides legal certainty.

7.2: Any amendments to the regulation should be the result of a robust rulemaking process that results in a clear rule and takes into account costs and late fees' deterrence value and impact on consumer conduct.

The current regulation was based on the FRB's careful study and research, as well as a robust, evidence-based rulemaking process, with input from consumer groups and industry participants. Before revisiting the provision, the Bureau should conduct a thorough review and analysis. Moreover, pursuant to the Truth in Lending Act, the Bureau must consult with the federal banking agencies when issuing revisions to the regulation, including the safe harbor provisions.[59] The Bureau should also retain the yearly inflation adjustment.

Further, the current language around the reasonable and proportional cost calculation is vague. If the Bureau were to adjust the safe harbor, it would need to provide well-defined criteria that issuers could use to determine what a reasonable and proportional late fee would be, as well as a safe harbor consistent with the factors laid out in the Truth in Lending Act,[60] including not just costs, but also the effect on deterrence and consumer conduct. The process should provide a clear rule in line with Director Chopra's vision for the Bureau as described in a recent blog post: "The CFPB is seeking to move away from highly complicated rules that have long been a staple of consumer financial regulation and towards simpler and clearer rules."[61] While the Associations would not support a reduction in the safe harbor, a non-nominal safe harbor amount would be preferable to its elimination. If the safe harbor were eliminated, the Bureau would need to provide significantly more detail and clarity around the costs included in the "reasonable and proportional" calculation.

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[58] For example, ABA stated in its comment letter on the FRB's proposal and continues to believe that *all* costs, including losses, should have been considered when determining a "reasonable and proportional" penalty fee, and that achieving meaningful late payment deterrence should have received greater consideration when the safe harbor was set.

[59]15 U.S.C. § 1665d(b) and (e).

[60] 15 U.S.C. § 1665d(c). If revised, the Bureau should allow issuers to incorporate other factors beyond costs in a "reasonable and proportional" calculation, including losses associated with late payments as well as the deterrence effect and consumer conduct effect.

[61] CFPB, Rethinking the Approach to Regulations (2022).

VIII. The Bureau must comply with the Small Business Regulatory Enforcement Fairness Act (SBREFA) and the Regulatory Flexibility Act if it amends the regulation.

Under SBREFA and the Regulatory Flexibility Act, agencies must conduct sufficient analyses to measure and consider the regulatory impacts of a proposed rule if the agency, in consultation with the Small Business Administration and the Office of Information and Regulatory Affairs, determines that there will be a significant economic impact on a substantial number of small entities.[62] Of the approximately 824 credit card-issuing banks, more than half (452) have assets less than $750 million, and of the 3,172 credit card-issuing credit unions, nearly 85 percent (2,682) have assets less than $750 million.[63] As discussed, reducing the amount issuers may charge for late payments would potentially have a significant impact on all issuers and cause them to alter their business models. As explained, the impact on small entities will be greater. Some have indicated they may have to consider exiting the market. Due to the potential significant impact on a substantial number of small institutions, the Bureau must convene a SBREFA panel to consider the effect of any proposed amendments on small entities.

Conclusion

Late fees are an important tool for encouraging consumers to pay on time and develop good financial management habits, which can help them build a good credit history and avoid being overwhelmed as unpaid balances rise. Reducing or eliminating that incentive to pay on time would lead to more late and missing payments, resulting in lower credit scores, reduced access to credit, and higher costs. Moreover, consumers would be further harmed as issuers adjust to the new risks associated with the higher rate of late payments by reducing credit lines, tightening standards for new accounts, and raising APRs for all consumers, including those who pay on time.

The safe harbor, which is based on significant research, input from all stakeholders, and a detailed, careful rulemaking process, while imperfect, covers a significant portion of issuer costs, offers meaningful encouragement to pay on time, and provides legal certainty to issuers and consistency to consumers. For these reasons, we do not believe that changes are necessary. However, if the Bureau proceeds with amending the regulation, it must comply with SBREFA. In addition, it should conduct detailed analysis and research and gather input from market participants. Further, in determining acceptable late fees, whether for the safe harbor or issuer-specific determination, the regulation should specifically allow fees to reflect not only costs but also how the fees incentivize on-time payments and influence consumer conduct, as the Truth in lending Act requires. Moreover, amendments should clarify the criteria issuers may use to determine whether a late fee is "reasonable and proportional." The end

[62] *See* 5 U.S.C. § 603.

[63] The number of card-issuing depository institutions is based on an analysis of bank, credit union, and thrift balance sheets. Those with nonzero credit card loan balances were included as card issuers.

result should be a clear rule consistent with Director Chopra's vision of clear and simple regulations, especially for small issuers.

Sincerely,

AMERICAN BANKERS ASSOCIATION

CONSUMER BANKERS ASSOCIATION

CREDIT UNION NATIONAL ASSOCIATION

NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS