Walking the Tightrope Between Bank Profits and Consumer Protection

By Lawrence ‘D’ Pew, Arizona Bankruptcy Lawyer

A recent rule proposal from the Consumer Financial Protection Bureau (CFPB) walks the line between preserving bank profits and strengthening consumer protection.

The CFPB was established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The fledgling bureau’s central mission is:

> *“[T]o make markets for consumer financial products and services work for Americans – whether they are applying for a mortgage, choosing among credit cards, or using any number of other consumer financial products.”*

On its official website, the CFPB lists its seven core functions:

1. To conduct rule-making, supervision, and enforcement for federal consumer financial protection laws.
2. To restrict unfair, deceptive, or abusive acts or practices.
3. To take consumer complaints.
4. To promote financial education.
5. To research consumer behavior.
6. To monitor financial markets for new risks to consumers.
7. To enforce laws that outlaw discrimination and other unfair treatment in consumer finance.

After one of its first confrontations with the banking industry, the CFPB has backed away from its earlier pro-consumer position limiting pre-activation and annual fees that banks could charge borrowers to open new credit card accounts.

First Premier Bank & Premier Bankcard v. CFPB & U.S. Treasury Dept.

CFPB’s first director, Richard Cordray, pulled the agency away from its original hard-line pro-consumer position to a more bank-friendly proposed 2012 rule. The agency reacted to a South Dakota federal lawsuit brought by Sioux Falls’ First Premier Bank & Premier Bankcard challenging the CFPB’s restrictive 2011 rule (Reg. §226.52 within Regulation Z). *First Premier Bank and Premier Bankcard, LLC v. CFPB & U.S. Treasury Dept. (Case 4:11-CV-04103-KES 9/23/11).*

On July 20, 2011, First Premier sued the CFPB alleging that Reg. §226.52, scheduled to take effect that October, would *“shut down First Premier’s program, halt underserved consumers’ access to unsecured credit cards and put a substantial number of First Premier employees in South Dakota out of work.”*

In brief, First Premier was charging $75 annual fees and $95 processing fees on new accounts with credit limits as low as $300. The consumers of these new accounts had low FICO scores and, consequently, were considered high-risk borrowers. *Importantly, these fees were incurred before the credit card accounts were activated as upfront costs to open new accounts.* First Premier argued that Reg. §226.52 infringed upon the bank's ability to price its credit card products based upon risk in lending to low-FICO-scored consumers. (Reg. §226.52 included "the total amount of fees" in the 25% fee limit imposed on banks. Furthermore, proposed amendments would include all fees "during the first year" and "prior to account opening.") First Premier argued that the government overstepped its authority with Reg. §226.52 to include pre-account start-up fees in the 25% first-year fee cap on credit cards agreements.

First Premier prevailed. The U.S. District Court, District of South Dakota, Southern Div., granted First Premier's motion for preliminary injunction effectively postponing the effective date of Reg. §226.52 of Regulation Z and enjoined, or stopped, the CFPB from enforcing the rule.

Fee Limits Under the Credit Card Act of 2009

The rule at issue in the South Dakota case – Reg. §226.52 – stems from the Credit Card Act of 2009. The Credit Card Act caps credit card fees at 25% of the total credit limit the borrower has available in the first year of the account. (For example, a credit limit of $1,000 in the first year of the new account would mean the bank's fees could not exceed $250.) When CFPB's predecessor, the U.S. Treasury, imposed Reg. §226.52, it used the words "total amount of fees" to describe what made up the 25% bank fee limit. *The issue in First Premier v. CFPB was whether pre-account fees should be included in the 25% cap or not – in its lawsuit First Premier said "not" and the Court agreed.*

Rebuilding Credit with High Rate Bankcards

Banks like First Premier extend credit to consumers whose FICO-rating was damaged by a financial event like foreclosure or bankruptcy. (There are other reasons why credit scores may be low, such as the absence of a credit history with young borrowers.) Many individuals who have struggled through foreclosure and bankruptcy will consent to just about any start-up fee and APR promotional rate simply to begin re-establishing their credit rating. *(In February 2011, First Premier offered new credit cards accounts with a 79.9% APR to low-FICO-scored borrowers!)*

Individuals with not-so-good credit – the subprime borrowers – typically pay more in credit card fees than individuals with good credit scores. On the one hand, when there are limits on the fees that banks can charge, consumers save money. On the other hand, when credit card fees are too low to offset risk, banks are much less willing to extend credit. Therefore, more credit card applicants would be rejected. This further restricts the availability of credit to subprime borrowers who hope to recover their credit rating after bankruptcy and foreclosure.

CFPB Proposes New Rule to Exclude Pre-Account Fees from 25% Cap

In the aftermath of First Premier v. CFPB, the bureau knows the pre-account fees reflecting credit-risk encourage banks to consider making loans to subprime borrowers. The CFPB also knows that this will result in the most financially vulnerable consumers paying more in fees. The agency is walking the tightrope between bank profits and consumer protection.

Earlier this month, the CFPB published its proposed rule in the Federal Register, essentially conceding to the merits of First Premier's argument. The rule allows banks to charge their processing and pre-activation fees without having those fees included in the 25% first-year fee limit on consumer credit cards.

ASIDE: *Richard Cordray took office through a congressional recess appointment by President Obama in January 2012. Critics claim the appointment violated the U.S. Constitution because Congress was not adjourned, a requirement for presidential recess appointments. Perhaps this is yet another reason why the new agency has backed away from the 2011 rule so as not to ruffle even more feathers in the banking industry and on Capitol Hill.*

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