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New CFPB Guidance Targets "Unfair" Returned Item and Overdraft Fees

On October 26, 2022, the Consumer Financial Protection Bureau issued two new guidance items discussing allegedly illegal deposit account fee practices. A new compliance bulletin, designated as Bulletin 2022-06, targets certain returned deposited item fees. The new circular, designated as Circular 2022-06, targets certain overdraft fees—primarily, fees assessed for so-called authorize positive, settle negative (APSN) transactions. Each of the publications was issued as part of the CFPB's larger initiative, commenced earlier this year, to reduce what it describes as "back-end junk fees" chargeable to consumers.

Both publications rely on the Consumer Financial Protection Act's prohibition of "unfair practices" as a basis for suggesting the subject fees are illegal. More specifically, that Act bars depository institutions from engaging in any unfair acts or practices. An *unfair* act or practice is one that causes substantial injury to consumers that is not reasonably avoidable, and for which the injury is not outweighed by countervailing benefits to consumers or competition. A monetary fee is a type of substantial injury. A fee or other injury is "reasonably avoidable" only where the consumer is fully informed of the risk, and has a practical means to avoid incurring the injury.

Returned Deposited Item Fees

The bulletin addressing returned deposited item fees takes aim at use of blanket policies of imposing fees for all returned transactions, without regard to any patterns of behavior on the account or circumstances indicating the depositor had reason to know the check might be returned. Per the CFPB, these policies are likely unfair and thus illegal. The CFPB reasoned that items may be returned for a number of reasons, such as insufficient funds or a stop payment order. The depositor will often have no control over whether an item is returned, and no reason to anticipate the item will be returned. Moreover, the depositor usually has no means to verify availability of funds in the drawer's account before deposit. Thus, the depositor may have no reasonable means of avoiding imposition of a returned item fee.

Per the CFPB, the injury caused to consumers by these fees is not outweighed by benefits to consumers or competition. The depositor gains no benefit from return, rather than payment, of an item. While an institution may use some fee revenue to reduce front-end costs or increase service quality, that benefit cannot outweigh the injury because even a full pass-through of fee revenue could only cause an even balance of benefit and injury. The CFPB does not view blanket fee policies as providing a benefit in the form of deterring fraudulent or improper conduct, as the fees are not targeted at those who can reliably avoid the return of an item—usually, the drawer of the check.

The bulletin does not suggest that all returned deposited item fee policies are illegal. If the institution uses a policy that only imposes fees on depositors who could reasonably avoid the fee, the CFPA prohibition on unfair practices is not triggered. As examples of permissible policy tailoring, the CFPB suggests limiting fees to consumers who repeatedly deposit bad checks from the same originator, or who deposit unsigned checks.

In order to allow institutions some time to accommodate the opinions in the bulletin, the CFPB stated it does not intend to seek monetary penalties for unfair returned item fees imposed before November 1, 2023.

APSN Overdraft Fees

The new circular focuses almost entirely on overdraft fees imposed for APSN transactions. Perhaps the most notable component of the circular is the CFPB's position that if a consumer can view his or her account balance via mobile application, online, ATM, or telephone, and the balance shows sufficient funds for an expected transaction, it is reasonable for the consumer to expect that no overdraft fee will be imposed for the transaction.

The CFPB reasoned that the increased prevalence of online banking and mobile banking applications has given consumers reason to believe that they can effectively monitor their accounts in real time. Per the CFPB, "if consumers are presented with a balance they can view in real-time, they are reasonable to believe they can rely on it." Consumers will not be required or expected to understand the effects of delay between transaction authorization and settlement, or the institution's processes for settling transactions.

Relying on these views, a consumer whose mobile banking or other account information source shows sufficient funds available for a transaction at the time of the transaction should not reasonably anticipate an overdraft fee for the transaction. Since the consumer should not anticipate the fee, the fee is not "reasonably avoidable" for purposes of the CFPA prohibition on unfair practices.

The circular also stated that a consumer should not expect to be subjected to a greater number of overdraft fees than the number of transactions for which the account lacked sufficient funds. More specifically, the CFPB noted that some institutions assess overdraft fees based upon the available balance reduced by debit holds, rather than the ledger balance, at the time of settlement. This means the institution is assessing a fee on a transaction the institution has already used in making a fee decision on another transaction. The net result can be imposition of more fees than would have been imposed if the ledger balance were used as a basis for fee assessment. Since the consumer should not expect imposition of these multiple fees, the fees are considered an injury that is not reasonably avoidable.

Under the same analysis as discussed earlier with respect to returned item fees, the "unavoidable" fees are viewed as substantial injuries to consumers that are not outweighed by a corresponding benefit, and are thus prohibited by the CFPA.

Effects as Policy Statements

The bulletin and circular are policy statements of the CFPB. They do not have the effect of law, and aren't binding on the courts. They advise the public and other enforcement authorities (e.g., the FDIC or state regulators) on the CFPB's position on the law, and of considerations the CFPB views as important. Thus, while institutions should take them into careful consideration, they are not the final determiners of whether a fee or other practice is illegal under the CFPA or other law.

Appeals Court Refuses Bank Effort to Shorten Customer Deadlines to Demand Electronic Transfer Refunds

In the recent opinion of *Rodriguez v. Branch Banking & Trust Co.*, the U.S. Court of Appeals for the 11th Circuit ruled that a bank's treasury management and bank services agreements with its customers cannot be used to shorten the one-year period allowed by the UCC for a customer to demand refund of unauthorized or unverified electronic transfers.

The customers at issue were a group of Venezuelan residents who had opened a series of deposit accounts at a bank branch in Florida. In connection with opening the accounts, the customers each entered into a Commercial Bank Services Agreement that required, among other things, a customer to report any unauthorized transaction from the account within 30 days. A Treasury Management Agreement was also executed in relation to one of the accounts, requiring the customer to report any

unauthorized transaction no later than 30 days after the date of the statement showing the transaction.

Over the course of several weeks beginning in August of 2016, a group of thieves (one of whom was allegedly a bank employee) changed the customers' online banking access passwords, leaving the customers without access to transaction information; impersonated the customers to authorize changes in security features protecting the accounts; and ordered electronic transfers of more than $850,000 from the customers' accounts to a fraudulent entity. The last of the transfers occurred in November of 2016.

During this time, the customers made many attempts to contact the bank to regain access to their account information, but were unsuccessful due to issues with Venezuela's telephone system and the bank's automated answering program. The customers finally made contact with the bank in early 2017. They regained access to their accounts in May of 2017 and discovered the improper transfers. The bank refused to refund the transfer amounts, and the customers sued. The bank defended against the refund claims on the basis that, among other things, the customers' account agreements required that any unauthorized transfer must have been reported within 30 days. As more than six months had passed since the transfers, the bank argued it was not liable for any refund. The trial court agreed with the bank, and the customers appealed.

On appeal, the Court of Appeals held that the key issue was whether the 30-day limitations in the customers' agreements could effectively limit the one-year period allowed by Article 4A of the UCC for customers to demand refunds of transfers. Article 4A allows a customer to agree to changes in most rules in the Article, but not if variation is specifically prohibited for the rule at issue. Section 204 of the Article requires a receiving bank to refund its customer for the principal amount of any unauthorized or unenforceable electronic transfer, and, so long as the customer reports the transfer within a reasonable time, to refund interest on the transfer amount. The customer can agree to vary the length of a "reasonable time" for purposes of the refund of interest, but the bank's obligation to refund cannot otherwise be varied. A separate section of Article 4A states that a customer cannot assert any claim for refund of a transfer more than one year after the customer first received notice of that transfer. That section is silent as to whether it can be changed by agreement.

The bank argued that because the rule imposing the one-year limitation did not specifically forbid variation by agreement, the customers were free to agree to a shorter period—such as the 30-day period used in the bank's agreements. The Court of Appeals disagreed. Except as to limiting the reasonable reporting period for the customer to recover interest, Article 4A forbids varying the bank's refund obligations for unauthorized or unenforceable transfers. Per the Court, shortening the one-year period established in the Article could greatly reduce the bank's principal refund obligation. A bank might, for example, require a customer to agree to an impractically short period that would largely absolve the bank from refund liability. While the UCC authors intended to allow shorter, yet reasonable, reporting periods as to interest so that customers would be incentivized to promptly report unenforceable transfers, the authors intended to make the bank's principal refund obligation unwavering and firm for the one-year customer demand period.

As the 30-day reporting limitations in the customers' agreements were unenforceable, the customers were not barred from demanding refunds of the principal transfer amounts more than 30 days after the transfers occurred. All of the transfers had been reported within the one-year period established by Article 4A, which was the relevant deadline. The case was transferred back to the trial court for appropriate proceedings to resolve the matter.

Understanding the UCC1: Decedents' Estates as Debtors

When an individual dies, many of his or her assets become an "estate" that is subject to the claims of creditors and beneficiaries. An estate isn't really its own legal entity, like a corporation or LLC. Instead, the estate can only act through a personal representative (called an executor if the individual died with a will, and an administrator if the individual died without a will). This is crucial when a lender extends credit to be secured by an asset of the deceased individual's estate. The estate itself can't grant a security interest. Any grant or conveyance has to be made by the estate representative, acting in his or her capacity as such.

For this reason, loan instruments will usually identify the named personal representative, in his or her role as executor or administrator of the estate, as the maker, grantor, or debtor under the instrument. For example, assume Bank is to extend credit to be secured by an asset of the estate of deceased John Smith, for which Susan Park has been appointed as executor. The security agreement would most likely name "Susan Park, as executor of the estate of John Smith" as the debtor providing the security agreement.

The usual practice in secured lending is to make sure that the debtor name shown in the security agreement matches the debtor name used in the UCC1 financing statement filed to perfect the security interest. But the usual practice can't be used when preparing a financing statement covering an estate asset. The UCC has a special rule for the name under which a financing statement covering a decedent's estate asset must be filed: the financing statement must show the name of the deceased individual as the debtor, and the financing statement must separately indicate the collateral is being administered by a personal representative. This indication should be made using the check-the-box option in Item 5 of the UCC1. The personal representative's name need not appear anywhere on the UCC1.

Returning to our earlier example, it's easy to see a mismatch between the underlying security agreement and the UCC1. The security agreement correctly names the debtor as Susan Park, as executor of the estate of John Smith. But the UCC1 must show the debtor name as John Smith. A lender that followed the usual practice of perfect matching between the security agreement and the UCC1 would be an unperfected creditor with an invalid UCC1.

As another twist to the ordinary rules for name determination, the UCC "driver's license rule"—that an individual's name is correctly shown in a UCC1 only if it exactly matches the individual's valid driver's license—does not apply to the name of the deceased individual. Instead, the lender can use the name of the deceased as shown in the letters testamentary or other court order that appointed the personal representative. That name may slightly differ from a driver's license that the individual held before death. Stated differently, the letters or order appointing representative aren't the exclusive sources of the valid name; but they are always a valid source. This is a major difference from the driver's license rule.

The layout of the UCC1 and related UCC1Ad and UCC1AP forms permit use of multiple debtor names in a single financing statement. The practical problem is that there is only a single Item 5 check-the-box option for the entire UCC1. So, if the box is checked in Item 5 to show involvement of a personal representative, but the UCC1 features multiple debtor names, a reader can't know which of the various named debtors is the deceased. A competing creditor might argue the UCC1 is invalid because it is misleading. The best practice in this situation is to use multiple UCC1 filings, assuring that the deceased is the only debtor shown on the filing that features the deceased's name. The remaining debtors should be shown in a separate UCC1 filing that does not have the personal representative option selected in Item 5.

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