May 1, 2023

Director Rohit Chopra
Consumer Financial Protection Bureau
31700 G St NW
Washington, DC 20552

Re: Credit Card Penalty Fees (Regulation Z)
Docket ID: CFPB-2023-0010

To Whom It May Concern:

My name is Nicholas Anthony and I am a policy analyst at the Cato Institute's Center for Monetary and Financial Alternatives. I appreciate the opportunity to provide input to assist the Consumer Finance Protection Bureau (CFPB) in its effort to reconsider credit card penalty fees under Regulation Z.[1] The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace, and the Center for Monetary and Financial Alternatives focuses on identifying, studying, and promoting alternatives to centralized, bureaucratic, and discretionary monetary and financial regulatory systems. The opinions I express here are my own.

Put simply, the CFPB's proposal to eliminate the option to adjust fees for inflation and restrict late fees at $8 would be a step in the wrong direction.[2]

Eliminating Inflation Adjustments Would Be a Mistake

The CFPB's proposal to eliminate inflation adjustments within the current safe harbor is concerning given it sets a poor standard for governance and contradicts the CFPB's own arguments elsewhere in the proposal.

It is understandable that the CFPB has inflation in mind given that inflation has been so high in recent years. However, the fact that inflation can change suddenly and dramatically is evidence that laws and regulations should include inflation adjustments when dollars are referred to.[3] Including an inflation adjustment ensures that laws and regulations can remain properly

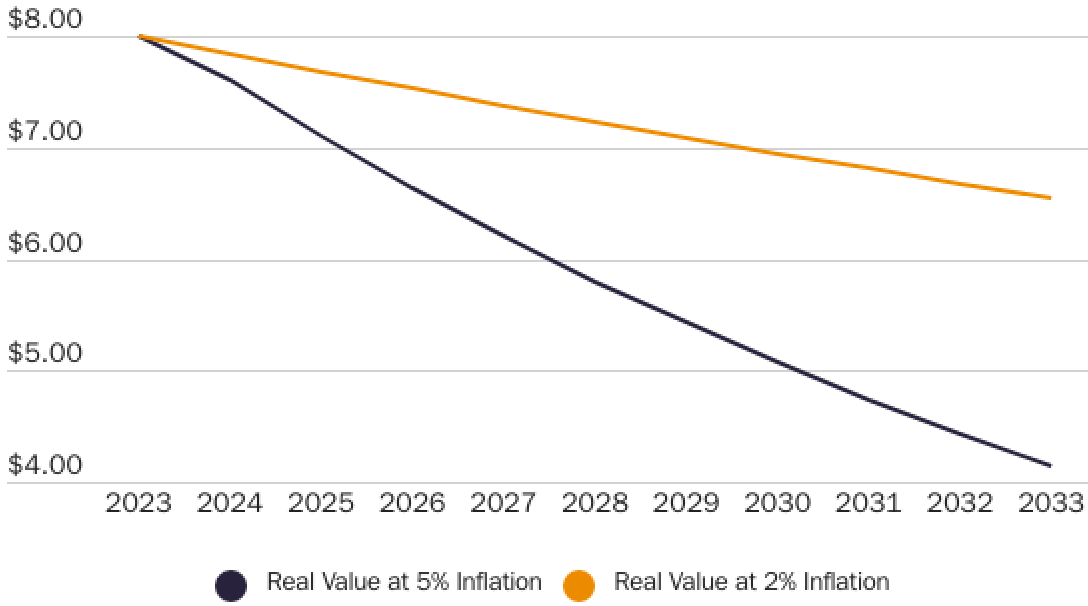
[1] Consumer Finance Protection Bureau, "Credit Card Penalty Fees (Regulation Z)," Federal Register, March 29, 2023, https://www.federalregister.gov/public-inspection/2023-02393/credit-card-penalty-fees-regulation-z.
[2] Ibid.
[3] For example, it has long been an issue that the reporting requirements under the Bank Secrecy Act were not indexed for inflation. What was originally set at $10,000 should now be equal to over $72,000. See Nicholas Anthony, "How Inflation Erodes Financial Privacy," Cato Institute, June 10, 2022, https://www.cato.org/blog/how-inflation-erodes-financial-privacy.

calibrated in the long term. For without these adjustments, inflation essentially acts as a tool to obscure and even hide policy changes.

The CFPB's headline stance may be that it *only* seeks to restrict fees at $8, but removing the inflation adjustment would effectively reduce that number further over time. Whether at the current inflation rate of 5 percent or even a more modest number of 2 percent, it would not be long before inflation reduces the real value of the fee to zero (Figure 1).

Figure 1

The real value of the CFPB's proposed price ceiling will cut in half in ten years at the current inflation rate



Note: Author's calculations

Eliminating the inflation adjustment also contradicts the CFPB's own argument that fees should be proportional to costs. Where inflation is an increase in the general level of prices, the costs of responding to late payments should be expected to rise much the same. Therefore, it makes little sense as to why the CFPB would go so far as to argue that it is seeking to match fees with costs, but then choose to ignore the costs people face.

If the CFPB's intention is to balance costs as it has argued throughout the proposal,[4] then any prices proposed should include adjustments for inflation. Otherwise, the CFPB cannot claim it is trying to match prices with costs. Rather, if inflation is omitted, the CFPB is trying to match prices with *costs it deems acceptable*. Worse yet, the CFPB is effectively saying that no costs would be acceptable—at least in real terms—in the long run.

[4] Consumer Finance Protection Bureau, supra note 1.

Choosing Central Planning over Competition Would Also Be a Mistake

The question of whether to include inflation when determining what price controls the CFPB deems fit may, however, be avoided entirely by simply not having price controls at all. Removing price controls would mean allowing competition to determine the appropriate fees for late payments. Competition would be a far more promising mechanism for efficient price determination given the CFPB's less than compelling argument that "Y-14 data and other information" was sufficient to decide what price would "cover most issuers' costs from late payments."[5] This determination may be ideal for a central planning board, but it fails to consider the costs of not addressing the full breadth of financial service providers and the potential changes to the market over time—considerations that only competition is best suited to address.

The difficulty in writing rules for the full breadth of financial service providers is not new or novel. When the Federal Reserve set the original safe harbor fees in 2010, it noted that "it is not possible based on the available information to set safe harbor amounts that *precisely reflect* the costs incurred by *a widely diverse group* of card issuers and that deter the optimal number of consumers from future violations" (Emphasis added).[6] Many years have passed, but it seems that little has changed. As noted in today's proposal, the CFPB is "concerned that setting a safe harbor amount" to cover all card issuers "could result in an amount that exceeds the costs for most card issuers."[7] In other words, both the Federal Reserve and CFPB have acknowledged that it is an impossible task for a single regulator to set an appropriate price of a service offered by credit card issuers large and small.

Early submissions to the CFPB's request for information have already brought this issue up on numerous occasions. Consider the following comment from Sun East Federal Credit Union:

> Credit Unions are member-owned, nonprofit cooperatives. For this reason, late fees and other fees imposed on member-owners are set with due care. Our rate and fee schedules reflect an effort to balance the costs of lending programs, fraud prevention, and operations against providing credit to members at a reasonable cost. The Rule presents a significant threat to operations and places credit unions at a competitive disadvantage to large card issuers.[8]

Issuers like Sun East Federal Credit Union should be able to set their fees with "due care" themselves.[9] They should be free to experiment with prices to find what works best for their individual needs. And just the same, consumers should be free to leave businesses when price experimentation leads to fees that are too high.

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[5] Consumer Finance Protection Bureau, supra note 1.
[6] 75 FR 37542, June 29, 2010, https://www.govinfo.gov/content/pkg/FR-2010-06-29/pdf/2010-14717.pdf.
[7] Consumer Finance Protection Bureau, supra note 1.
[8] Deborah Cook, "Comments Regarding Docket No CFPB-2023-0010 RIN 3170-AB15," Sun East Federal Credit Union, March 31, 2023, https://www.regulations.gov/comment/CFPB-2023-0010-0005.
[9] Deborah Cook, "Comments Regarding Docket No CFPB-2023-0010 RIN 3170-AB15," Sun East Federal Credit Union, March 31, 2023, https://www.regulations.gov/comment/CFPB-2023-0010-0005.

The difficulty in addressing potential changes over time is likewise not a new issue. As discussed above regarding inflation or more generally in terms of exogenous shocks like the COVID-19 pandemic, markets are constantly changing. Part of the reason the Federal Reserve incorporated an adjustment for inflation was because it recognized it would be more inefficient to constantly update the amount as the market changed.[10] Whether it be targeted price controls or broader central planning, the issue remains the same: government officials are not in a position to set efficient or optimal pricing. There is simply too much information dispersed across too many stakeholders with too many differing interests for one size to fit all.

Fortunately, there is a system for pricing that can remedy these problems: open competition.[11] Card issuers should have the freedom to review their costs, the value of deterrence, and market demand when considering alternative pricings. Furthermore, card issuers should have the freedom to recognize changing conditions and adjust their strategies on the spot. From there, the viability of those prices should be left to the market to decide.

The True Cost Falls on Customers

To its credit, the CFPB appears to recognize that its proposed price control is so strict that card issuers will likely end up using "interest rates or other charges to recover some of the costs of collecting late payments" or reducing "a cardholder's credit line and limit the cardholder's earning or redemption of rewards."[12] Others have noted as well that the proposal will likely result in some customers being priced out of the market entirely. For example, consider the following excerpt from a comment letter submitted by Securityplus Federal Credit Union:

> As a small credit union, *this proposal will* impose a disproportionate burden and *require us to raise other fees for all members, reduce dividends, consider eliminating our credit card products altogether*, or even explore a merger with a larger institution that is better able to forgo fee revenue and shoulder compliance costs.[13] (Emphasis added)

Or consider the following excerpt from a comment letter submitted by MC Federal Credit Union:

> Scale is another element the CFPB needs to understand. We offer a credit card program to 2,654 members. The costs to provide this product are not leveraged by the numbers. So understand that *your proposed action will have consequences* you may not have intended but will become reality. What would those consequences look like? We could *suspend [or] terminate* the privilege to use the card forcing them to go to a higher cost (interest rate) option. We could *tighten our approvals* and *force low income or underserved communities to*

[10] Consumer Finance Protection Bureau, supra note 1.
[11] Friedrich A. Hayek, "The Use of Knowledge in Society," American Economic Review, 1945, https://www.econlib.org/library/Essays/hykKnw.html.
[12] Consumer Finance Protection Bureau, supra note 1.
[13] Toby Green, "Comments Regarding Docket No CFPB-2023-0010 RIN 3170-AB15," Securityplus Federal Credit Union, April 14, 2023, https://www.regulations.gov/comment/CFPB-2023-0010-0037.

> *other costly and unregulated options*. We could decide to get out of the card business altogether. Who will win then?[14] (Emphasis added)

Who will win if consumers only have limited access to financial services? Who will win if consumers are fully priced out of the market? Who will win if consumers are denied accounts because financial service providers do not have the tools to mitigate risks? It won't be consumers.

These questions raise another line of inquiry: namely, why is the CFPB knowingly pushing such a proposal? Rodgin Cohen, Stephen Meyer, and Jennifer Sutton noted the issue early on stating, "The CFPB's conclusion that subprime consumers are not harmed when they are effectively priced out of the credit market seems inconsistent with the CFPB's efforts to expand access to credit to underserved segments of the population."[15] If the CFPB is to move forward with this proposal, it should publicly acknowledge that it is in fact pushing customers out of the market and explain how the CFPB believes those actions to be justified within its mission.

Conclusion

The CFPB deserves credit for drawing attention to Regulation Z, but the path offered in the proposal would be a step in the wrong direction. I thank you for offering this opportunity to comment and hope the next steps the CFPB takes are reconsidered.

Sincerely,

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[14] Jim Barbarich, "Comments Regarding Docket No CFPB-2023-0010 RIN 3170-AB15," MC Federal Credit Union, April 10, 2023, https://www.regulations.gov/comment/CFPB-2023-0010-0035.
[15] Rodgin Cohen, Stephen Meyer, and Jennifer Sutton, "CFPB Proposal Could Revolutionize Credit Card Late Fees," Law360, March 31, 2023, https://www.law360.com/articles/1586987.