What's a junk fee?

By Kate Berry

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Rohit Chopra, the director of the Consumer Financial Protection Bureau, raised hackles by launching a broad inquiry last week into so-called junk fees charged on run-of-the-mill financial products such as loans, mortgages and credit cards.

"Service charges inflate ticket prices, resort fees hike our costs to stay in hotels, and our phone bills are often laden with mystery charges," Chopra said in a Jan. 26 press call. "These junk fees make it harder for us to choose the best product or service, since the true cost is hidden. Banking is no different."

But this initiative has led bankers, consumers and policy experts to ask what exactly makes a fee a junk fee? Many bankers and lenders insist that fees they charge are related to specific types of work or services performed, and existing laws and regulations already prohibit excessive fees, so it isn't clear what problem the inquiry is designed to solve. “Nobody likes fees—and when you call them junk fees you like them even less,” said Pete Mills, senior vice president of residential policy at the Mortgage Bankers Association.

Existing consumer protection laws, including the 1968 Truth in Lending Act, already regulate fees. That law, known as TILA, protects consumers from inaccurate and unfair billing practices and requires that all lenders and creditors pre-disclose specific terms such as the annual percentage rate on a loan. The Credit Card Accountability, Responsibility, and Disclosure Act, passed in 2009, virtually eliminated penalty charges, reduced late fees and set general limits on credit card fees, studies have shown.

“I’m surprised by the breadth of the CFPB’s request for information given that the Truth in Lending Act really does regulate these fees,” said Amy Hanna Keeney, a partner at Adams and Reese in Atlanta. “If you’re a credit card issuer, a bank or a traditional creditor, Truth in Lending really limits what you can and can’t charge, and there needs to be a reasonable relationship between what you’re charging and what it actually costs to provide that service.”

The CFPB listed roughly 25 different fees ranging from balance-inquiry fees to card cancellation fees to inactivity fees, in its request. Chopra had already admonished the largest credit card issuers last month by claiming they engage in unfair or anticompetitive practices because just eight companies control 70% of the market.

"Exploitative junk fees charged by banks and non-bank financial institutions have become widespread, with the potential effect of shielding substantial portions of the true price of consumer financial products and services from competition," the CFPB said in its request.

Mortgage lenders in particular are objecting to the word “junk,” being associated in any way with fees that get rolled into the cost of a home loan. Mills and others note that mortgage lenders invested heavily to comply with the CFPB’s integration in 2015 of TILA with the Real Estate Settlement

Procedures Act, known as TRID. Most of the fees on home loans are third-party fees including state and local government property taxes, recording fees, home inspection fees, and homeowners' insurance.

In that regulation, the CFPB sought to address "surprises" that borrowers have faced when closing on a home loan by creating clearer disclosures and estimates of fees. The disclosures were specifically designed to help consumers clearly compare one lender's fee structure to another by showing the amount of each fee, what the fee was for, and which fees are charged by lenders versus third parties.

Borrowers currently receive a three-page loan estimate with a breakdown of fees when they first apply for a loan, and a closing disclosure that ensures most lender fees remain locked in and cannot rise by more than 10%. In addition, some fees such as title insurance are state regulated and so are not under the CFPB's purview.

Still, many experts think the CFPB will be looking to bring enforcement actions against companies if it finds fees disproportionately affect low- and moderate-income consumers or minority groups. The bureau likely would use its authority to regulate "unfair, deceptive and abusive acts and practices" — known as UDAAP — to address issues such as deceptive advertising.

"Bureau challenges to these fees would have to be based on its UDAAP authority, in the much same way it previously attacked products it thought were not suitable for consumers," said Scott Pearson, a partner and leader of consumer financial services at Manatt, Phelps & Phillips.

In its request, the CFPB is urging consumers to weigh in about their experiences with fees — for example, whether they think fees are too high given the cost of the product or service, or whether they "believe" fees are transparent and have clear disclosures. But asking consumers to weigh in on fees has renewed anxiety among creditors that the CFPB's complaint database will become a repository of negative reviews, akin to a Yelp.com for financial firms.

"What consumer is going to write that they love being charged a fee?" asked Joann Needleman, a member at Clark Hill who represents debt collectors. "No one is positive about paying fees."

The CFPB is particularly interested in fees that have a "hidden cost," such as being charged to maintain a prepaid card or to pay a bill, the bureau said in a Feb. 2 blog post. Some suggest Chopra's inquiry into junk fees is tied to the CFPB's upcoming proposal on consumers' right to control their own financial data. The bureau is in the thick of writing a rule, required by Section 1033 of Dodd-Frank, that would give consumers access to their bank transaction data. Some observers suggested the rule could lead to more competition based on costs and fees.

"This is another area where a 1033 rulemaking has the potential to bring more and better choices to consumers," said John Pitts, head of policy at the data aggregator Plaid, and a former CFPB deputy assistant director. "Transparency and choice drive competition that is good for consumers and supports honest businesses, especially those looking to deliver services for more people at lower cost."

Since taking the reins of the CFPB in October, Chopra has leveled much of his ire at banks' overdraft fees. Yet even as bank after bank has slashed overdraft fees to as low as $10, Chopra has continued to excoriate the practice. Beyond overdraft, the CFPB has late fees and non sufficient funds fees in its sights. But regardless of what the CFPB decides makes a fee a junk fee, in the meantime Chopra has put lenders back on their heels just by coining the term.

“The director has the view that the bully pulpit is one of the more effective tools he has at his disposal,” Pearson said.