

UDAP – Analysis, Examinations, Case Studies, and Emerging Risks

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Overview

- Legal Authority and Analysis
- Case Studies
- Emerging Risks
- Holding Company Impact
- Tips for Compliance
- Resources
- Questions

Legal Authority and Analysis

- Overview
 - Dodd-Frank Act (DFA) authority re unfair, deceptive or abusive acts or practices (UDAAP)
 - Federal Trade Commission Act (FTC Act) authority re unfair or deceptive acts or practices (UDAP)
 - Act or practice
 - Unfair act or practice
 - Deceptive act or practice
 - Relationship to other laws

DFA UDAAP Authority

- Source of authority:
 - Sections 1031 and 1036 of the DFA
- Consumer Financial Protection Bureau (CFPB) authority:
 - CFPB has UDAAP rule writing authority – the UDAAP rules will be applicable to any person that engages in offering or providing a consumer financial product or service (covered person) and any service provider
 - CFPB has UDAAP supervision and enforcement authority for depository institutions above \$10 billion and nonbank entities

DFA UDAAP Authority *(continued)*

- Prudential regulators have UDAAP supervision and enforcement authority for depository institutions of \$10 billion or less
- Unfair (similar to Section 5 of the FTC Act)
- Deceptive (similar to FTC Act guidance)

DFA UDAAP Authority *(continued)*

- Abusive (new in the DFA) is defined as an act or practice that:
 - Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
 - Takes unreasonable advantage of:
 - A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
 - The inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or
 - The reasonable reliance by the consumer on a covered person to act in the interests of the consumer

FTC Act UDAP Authority

- Source of authority:
 - Section 5 of the FTC Act, Section 8 of the Federal Deposit Insurance Act
- Authority of prudential regulators (but not the CFPB):
 - No rule writing authority
 - Supervision and enforcement for supervised entities (any asset size)

Act or Practice

- Applies to *all* products and services
- Applies to *every* stage and activity
 - Product development and rollout
 - Advertising
 - Direct marketing
 - Disclosures
 - Contracts
 - Account statements
 - Billing
 - Loan servicing/loss mitigation/collections
 - Third-party service providers

Unfair Act or Practice

- An act or practice is unfair where it -
 - Causes or is likely to cause substantial injury to consumers,
 - Can not be reasonably avoided by consumers, and
 - Is not outweighed by countervailing benefits to consumers or to competition
- Public policy may be considered

Unfair Act or Practice *(continued)*

- Injury - Causes or is likely to cause substantial injury to consumers
 - Injury: Usually involves monetary harm
 - May include other tangible harm
 - Does not include emotional or other subjective harm
 - Substantial:
 - Small amount of harm to a large number of people
 - Significant risk of concrete harm to small number of people
 - Not trivial or speculative harm

Unfair Act or Practice *(continued)*

- Not reasonably avoidable – Can not be reasonably avoided by consumers
 - The Federal Reserve will consider whether the act or practice:
 - Unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision making,
 - Interferes with the consumer’s ability to effectively make decisions, or
 - Subjects consumers to undue influence or coercion

Unfair Act or Practice *(continued)*

- Not outweighed by benefits - Is not outweighed by countervailing benefits to consumers or to competition
 - Offsetting benefits to consumers may include:
 - Lower prices
 - Wider availability of products and services
 - Also consider the offset of costs to remedy or prevent the injury, such as:
 - Cost to the bank to take preventive measures
 - Cost to society of any increased burden

Unfair Act or Practice *(continued)*

- Public policy (as established by statute, regulation, or judicial decisions) may be considered
 - Public policy cannot serve as the primary basis for a UDAP determination

Deceptive Act or Practice

- An act or practice is deceptive where -
 - There is a representation, omission, or practice that misleads or is likely to mislead the consumer;
 - The consumer's interpretation of the representation, omission, or practice is considered reasonable under the circumstances; and
 - The misleading representation, omission, or practice is material

Deceptive Act or Practice

(continued)

- Misleading – There is a representation, omission, or practice that misleads or is likely to mislead the consumer
 - Representation: Express or implied claims or promises, written or oral
 - Omission: Disclosure of the omitted information is necessary to prevent a consumer from being misled
 - Misleading: The Federal Reserve will evaluate the representation or omission in the context of the entire advertisement, transaction, or course of dealing – Actual deception is not required

Deceptive Act or Practice

(continued)

- Reasonable interpretation - The consumer's interpretation of the representation, omission, or practice is considered reasonable under the circumstances
 - The act or practice need not be likely to deceive all consumers
 - The act or practice will be considered from the perspective of the reasonable consumer or target audience
 - Oral disclosures or fine print may be insufficient to cure a misleading headline or prominent written representation, especially if the consumer was directed away from limitations

Deceptive Act or Practice

(continued)

- Material - The misleading representation, omission, or practice is material.
 - Material: Likely to affect a consumer's decision regarding a product or service, such as information about costs, benefits, or limitations
 - Express claims and false claims: Presumed material
 - Implied claims: Presumed material if it is demonstrated that the bank intended the consumer to draw certain conclusions
 - Omissions: Presumed material if the bank knew or should have known that the consumer needed the omitted information to evaluate the product or service

Relationship to Other Laws

- Acts or practices that are unfair or deceptive may also violate other laws, such as:
 - Truth in Lending Act
 - Truth in Savings Act
 - Equal Credit Opportunity Act
 - Fair Housing Act
 - Fair Debt Collection Practices Act
- However, an act or practice does *not* have to violate another law to be unfair or deceptive

Case Studies

- Overview
 - Mortgages
 - Automated Overdraft Programs
 - Overdraft Billing
 - Deposit-Related Products
- Caveat: The UDAP analysis is highly dependent on the facts and circumstances of a particular matter

Case Studies *(continued)*

- Mortgages: Income Fraud
 - Practice: The bank's underwriters intentionally misrepresented consumers' income, assets, and debts to meet purchaser guidelines
 - How discovered: Customer complaints to the state, complaint investigation, target examination, full-scope consumer compliance examination

Case Studies *(continued)*

- Mortgages: Unearned Discount Points
 - Practice: The bank falsely represented on the HUD-1 Settlement Statement that origination points were discount points. There was no corresponding discount off the par interest rate
 - How discovered: Examination

Case Studies *(continued)*

- Automated Overdraft Programs
 - Practice: Prior to the effective date of Regulation E, the bank failed to provide consumers with information about overdraft alternatives, discouraged consumers from opting out, failed to monitor consumer usage of the product, and failed to implement effective repeat usage controls
 - How discovered: Complaint, examination

Case Studies *(continued)*

- Overdraft Billing
 - Practice: The bank's method of posting point-of-sale (POS) debit transactions resulted in multiple overdraft fees for a single POS debit transaction
 - How discovered: Complaint, target examination

Case Studies *(continued)*

- Deposit-Related Products: Certificate of Deposit
 - Practice: The bank provided consumers with a Truth In Savings Act (TISA) disclosure stating that the bank would renew the CD at a certain rate. However, the bank programmed its systems to renew the CD at a lower rate. The bank knew of the problem through consumer complaints and an internal audit
 - How discovered: Bank's internal audit report

Emerging Risks

- Claims of improving credit
- Zombie debt (past statute of limitations)
- Servicing practices
- New sources of fee income
- Third party vendor management

Holding Company Responsibilities

- Identify, measure, monitor, and control risks across the consolidated organization
 - Enterprise-wide compliance risk management program
 - Enterprise-wide internal audit program
 - Board oversight of enterprise-wide programs

Holding Company Impact

- Consumer compliance supervisory concerns identified by the Federal Reserve or another regulator may impact:
 - One or more components of a holding company’s overall risk management rating
 - Board and senior management oversight
 - Policies, procedures and limits
 - Risk monitoring and management information systems
 - Internal controls
 - The overall consolidated holding company rating most commonly due to the significant deficiencies in the overall risk management rating

Holding Company Impact Example

- UDAP issue:
 - Deceptive debt collection and credit card marketing practices
 - Associated deficiencies in compliance risk management and internal audit
- Approximately 250,000 affected customers

Holding Company Impact

Example *(continued)*

- Supervisory actions (consolidated)
 - Restitution totaling \$85 million
 - Civil money penalties totaling \$27.5 million
 - Consent orders from four regulatory agencies, including one at the holding company level

Holding Company Consent Order Components

- Source of strength
 - Fully utilize financial and managerial resources to serve as a source of strength to subsidiary banks
 - Ensure that banks comply with supervisory actions
 - Ensure that banks comply with consumer financial laws
- Board oversight
 - Written plan to strengthen oversight of enterprise-wide compliance risk management program

Consent Order Components

(continued)

- Compliance Risk Management Program
 - Written plan to strengthen enterprise-wide compliance risk management program with respect to compliance with all consumer protection laws, rules, and regulations
- Audit
 - Written plan to enhance internal audit program with respect to compliance with consumer compliance with consumer financial laws, rules, and regulations in the marketing, processing, and servicing of consumer products

Tips for Compliance

- Conduct Internal Reviews
 - Incorporate UDAP review into the life cycle of a product/service (include all customer touch points) and determine whether any product/service could be considered unfair or deceptive
 - If any issues are identified and a consumer is harmed, identify all potentially affected consumers and ensure appropriate corrective action is taken to resolve issues

Tips for Compliance *(continued)*

- Conduct Internal Reviews *(continued)*
 - If the bank is considering a new product or making changes to product terms, features or fees, make sure to consider both the technical regulatory requirements and UDAP
 - Banks should be particularly concerned if product revenue depends on consumers making what seem like poor choices, such as using a product excessively
 - If so, perform a rigorous UDAP review and consider what steps should be taken to mitigate the risk of unfair or deceptive practices

Tips for Compliance *(continued)*

- Review Customer Complaints
 - Review complaints and identify trends (trends may indicate a closer look is warranted)
 - Determine whether any complaints raise UDAP concerns
 - Expand review to include consumers who have not complained

Tips for Compliance *(continued)*

- Review Advertising/Marketing
 - Look for advertisements that could be viewed as unfair or deceptive (e.g., misrepresentations, promotion of terms that are not widely available, etc.)
 - Consider how cost, value, availability, alternatives, cost savings, benefits, or terms are represented
 - Consider whether the terms advertised are actually available to most consumers

Tips for Compliance *(continued)*

- Review Loan Officer Compensation Practices and Programs
 - If the lender offers an incentive compensation program (for any product, not just mortgages), identify products, product features, services, referrals and sales goals or behaviors that qualify for rewards under the program
 - Evaluate the quality and impact of controls on the compensation program
 - Finally, assess whether the program incentivizes behaviors or practices that result in heightened UDAP risk

Tips for Compliance *(continued)*

- Review Third Party Relationships
 - Consider any third party vendors who offer or service any aspect of any product/service (remember customer touch points)
 - Review whether policies/processes (i.e., risk and monitoring controls) are in place for selecting and managing third party relationships
 - Know how third parties/bank are compensated in the relationship

Tips for Compliance *(continued)*

- Review Third Party Relationships *(continued)*
 - Conduct reviews and identify whether any of the third party activities could be considered unfair or deceptive acts or practices
 - Review complaints lodged against the vendor, including complaints sent directly to the third party
 - Conduct an independent assessment of the third party's activities to verify compliance with both technical requirements and UDAP

Resources

- [Consumer Affairs Letters](#)
 - [CA Letter 04-2](#): “FRB and FDIC Joint Statement re Unfair or Deceptive Acts or Practices by State-Chartered Banks “
 - [CA Letter 05-2](#): “Interagency Guidance on Overdraft Protection Programs”
 - [CA Letter 07-8](#): “Consumer Compliance Examination Procedures for the Unfair or Deceptive Acts or Practices Provisions of Section 5 of the Federal Trade Commission Act ”

Resources *(continued)*

- Consumer Compliance Articles, Webinars, and Teleconferences
 - [Consumer Compliance Outlook Newsletter](#)
 - [Consumer Compliance Outlook Live Webinars](#)
 - [Ask the Fed Conference Calls](#)
 - [Community Banking Connections Newsletter](#)

Questions

