

UDAAP: Unfair, Deceptive or Abusive Acts or Practices

Gregory Imm
Chief Compliance Officer
Fifth Third Bank

April 2014

What is the Difference Between Fair Lending and Responsible Lending?

- Fair Lending
 - “Fair, equitable, and nondiscriminatory access to credit for consumers”
 - Section 1002(13) of the Dodd-Frank Act
- Responsible Banking
 - No statutory definition
 - Focuses on equitable and fully disclosed lending processes and product terms in consumer credit transactions
 - Prohibits unfair, deceptive or abusive acts or practices (UDAAP)
 - Evolving and fluid concept; now includes “fairness” concept and deposit products

UDAAP History

- Section 5 of the FTC Act prohibits unfair or deceptive acts or practices; Dodd-Frank Act added new “abusive” prong (UDAAP)
- Scope: All products (lending and deposits)
- Although typically applied in consumer transactions, UDAAP has also been applied to business transactions (e.g., business credit cards)

UDAAP Definition

“Unfair”

- Causes or is likely to cause substantial injury to consumers
- Cannot be reasonably avoided by consumers
- Is not outweighed by countervailing benefits to consumers or to competition

Unfair - Examples

Consumer's actual decision won't be judged here

Standard is whether practice interfered with rational and reasonable decision-making process

Example: important information left out of an ad

Consumer cannot make a rational decision regarding the product because all relevant facts are not available

UDAAP Definition

“Deceptive”

- A representation, omission, or practice misleads or is likely to mislead the consumer
- A consumer’s interpretation of the representation, omission, or practice is considered reasonable under the circumstances
- The misleading representation, omission, or practice is material

Deceptive - Examples

Can mislead by what is not said as well as by what is said

Even if all relevant information is included and accurate, layout or structure, or the manner message communicated may be misleading, if attention is directed away from important information

Bait-and-switch is an example of a misleading practice

UDAAP Definition

“Abusive”

Materially interferes with ability of consumer to understand a term or condition of the product or service, or takes unreasonable advantage of:

- Lack of understanding by a consumer of material risks, costs, or conditions of product/service
- Ability of consumer to protect interests of themselves in selecting or using product/service
- Reasonable reliance of a consumer on the banker to act in their interest

The CFPB is not expected to issue regulations further defining these concept

Abusive - Examples

Not limited only to the disclosure process

Taking unreasonable advantage of a consumer's lack of sophistication if institution fails to prevent overuse of certain services that generate fees (Overdraft is an obvious example)

FDIC's guidance:

“if a customer overdraws his or her account on more than six occasions where a fee is charged in a rolling twelve-month period, [the institution is to] undertake meaningful and effective follow-up action.”

Abusive - Examples

Offering products or services to consumers having a low level of sophistication and clearly do not fully understand financial concepts

Rely on model disclosure forms?

Might not be enough if consumer still can't understand complexities of a product or service

“Acts & Practices”

- All products
- All functions
- All relationships
- Non-product activities

So what we have focused on is
significant....

1. Focus on fees

- Above-average fee income
- Fees unrelated to costs
- Hard-to-explain charges
- Delayed & penalty charges
- “Fads” from industry and vendors

2. Focus on clarity

- Don't over-rely on disclosure
- Gear disclosures to customer need and capacity
 - (Pew research finds median 111-page checking disclosure)
- Make disclosures timely
- Make post-opening communications clear and helpful
- Explain well in *all* channels
- If something can't be explained, consider not doing it

3. Focus on vulnerable customers (especially for “abuse”)

- Not “Suitability” but....
- Abuse hits vulnerable customers
 - Elderly
 - Young
 - Minority
 - Limited education or English skill
 - Lower income
 - Financial distress
- Use *extra* care in terms, marketing, sales, and disclosures

4. Follow the complaints!

- Complaints are gold mine
- Gather all:
 - Written and oral
 - To bank, regulators, & online
- Centralize analysis
- Trace the source – technically legal, where customers say “unfair” or “unclear”
- These are UDAAP risks!

5. Do research

- For controversial issues, use focus groups
 - Match to target customers
 - Assess understanding
 - Assess value perception
- Also survey customers
- Make indicated changes
- Monitor for likely issues
- Document it all – Be “data-driven”

6. Monitor value received

- Monitor whether most customers got the advertised terms
 - Avoid “bait and switch”
- Monitor customers who trigger penalty terms
- Monitor claims paid on insurance-like or protection products

7. Manage third parties

- Brokers and dealers
- Sales people
- Affiliated firms
- Sales finance arrangements
- Service vendors

8. Align incentives

- Avoid incenting oral deception
- Avoid incenting adverse pricing
- Include third parties
- Compensate managers on compliance and ethics

9. Address state law

- Almost every state has UDAP-like statutes
- Many have private right of action
- State regulators and AG's activated
- Federal preemption weakened

10. Listen well

- Open easy channels for:
 - Customers
 - Reviewers
 - Employees

11. Integrate whole bank

- Manage **whole product life cycle**
- Integrate across risk siloes
- Update roles of compliance and legal
- Integrate with business lines
- Establish enterprise focus at top of the house

Preparing for Exams

- Be sure customer understands *absolutely everything*
- Disclosures must be crystal clear and obvious
 - Don't assume that model forms in regulations fit the bill and need no supplement
 - Additional explanatory documents or communications?
 - Consider even acknowledgment forms where consumers sign or initial that they understand the consequences of their choices. Again this is not a get-out-of-jail-free card, but it is better than not being able to respond to an accusation of abuse

Preparing for Exams

- Understand your target audience
 - Level of education
 - Financial sophistication
 - Risk appetite
 - Vulnerabilities
 - Financial position, and so forth
- This is a product-by-product determination as well as for the overall institution

Preparing for Exams

- CFPB and prudential regulations may still impose liability for the choices of your customers, despite best of intentions and clearest communications, if they conclude those decisions were not in the customers' interest
 - What will that standard be? We don't know yet
- Consider situations where consumers selections are clearly not in their best interests
 - Examine the decision-making, disclosure and communication processes to determine if different choices (forced or not) can be made
 - This may include refusing certain products and services for certain consumers

Preparing for Exams

- Are your consumer customers given choices of products and services
- How is the selection process handled?
 - Are alternatives pointed out and pursued?
- What happens, more beneficial products are introduced after more expensive ones are already on the market?

Responsible Banking “Defined”

- No statutory definition
- Focuses on equitable and fully disclosed lending processes and product terms in consumer credit transactions
- Prohibits unfair, deceptive or abusive acts or practices (UDAAP)
- Evolving and fluid concept; now includes “fairness” concept and deposit products
- “Risk to Consumer” (RTC) is paramount

Our Definition

Customer engagement with the primary focus of understanding the customer's needs and taking steps to ensure the costs, benefits and options are key components of that engagement, as well as equal access, and safeguards against financial abuse.

This has become our minimum benchmark for “compliance.” There are technical rules that apply (fair lending and UDAAP most explicitly), but the testing is built to evaluate the effectiveness of the ***Responsible Banking Program.***

[Small] Sample of Responsible Banking Analyses

- Evaluate fees to determine if established based on the services rendered, competition or market tolerance
- Review new account terms and conditions for accuracy and readability, and determine if they are sensitive to the sophistication of the target audience
- Compare disclosures to actual practices and related marketing
- Determine that product fulfillment matches the promotion - *customers get what they are promised*
- Evaluate the extent to which products are marketed to vulnerable segments, including students, military, immigrants, low-income, etc
- Ensure that products designed for mass market have a migration path to “prime” or “preferred” products
- Ensure that customers in products considered “non-prime” have a periodic re-evaluation to determine continued product appropriateness

Questions