UNFAIR, DECEPTIVE, OR ABUSIVE ACTS AND PRACTICES (UDAAP)

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A BIT OF HISTORY

- **UDAAP** can be traced way back to 1938, with its roots in Section 5 of the FTC act, tackling **“unfair methods of competition”** in the anti-monopoly era.
- The Act was expanded in 2004 to specify prohibitions on **“Deceptive”** and **“Unfair”** practices, and then again in 2010 via Dodd-Frank to add **“Abusive”** practices.

Thus, UDAP became UDAAP!

The CFPB has authority to regulate UDAAPs and shares enforcement responsibility with the FTC.

A DISCLOSURE OF SORTS…

UDAAP is inherently subjective!

- No set dollar thresholds
- No absolute figures, limits, or black-and-white requirements
- No disclosures, model forms, or sign-offs.
- May be an enhancement, add-on, or escalation tool applied to other regulatory violations

ELEMENTS OF UDAAP

- Unfairness
- Deceptiveness
- Abusiveness

ELEMENTS OF UDAAP

Unfairness:

1. It causes or is likely to cause substantial injury to consumers;
2. The injury is not reasonably avoidable by consumers; and
3. The injury is not outweighed by countervailing benefits to consumers or to competition.

UNFAIRNESS

Unfairness – 1: It causes or is likely to cause substantial injury to consumers.

In short, it costs money. Monetary harm is the most direct and readily identifiable harm.

- Higher fees or interest
- Lost benefits
- Denial of access to a product or service

- The harm may be actual (it happened), likely or potential, based on facts.
- A small number of customers charged a large amount, or a large number charged a small amount – both are considered “substantial injury”.

UNFAIRNESS

Unfairness – 2: The injury is not reasonably avoidable by consumers

A practice is **not considered unfair** if consumers **may reasonably avoid injury.**

If the act/practice interferes with their decision making – it may not be reasonably avoided. Is it practically possible for the consumer to avoid the injury?

- Information changing after committing, information withheld, and coercion interfere with decision-making
- Transactions executed without their knowledge or consent remove the decision-making power of the consumer
- Discrimination – inherently unfair, the consumer has no way to avoid this

Does the act or practice hinder the consumer's ability to make a decision or take an action to avoid the "injury"?

UNFAIRNESS

1. **Unfairness – 3:** The injury is not outweighed by countervailing benefits to consumers or to competition.

The **Net Effect** of the act or practice is to cause injury, rather than a competitive benefit, such as:

- Wider product availability
- More services
- Lower consumer prices

Public policy, statute, regulation, etc. alone do not determine what is unfair, but may be considered as a factor

UNFAIRNESS

Unfairness Examples

- Charging application fees twice when co-applicants are not married vs. once to married applicants
- Failure to release a lien after a loan is paid
- Delaying the posting of received payments so as to trigger increased fees
- Modifying the order of items presented to maximize the overdrafts triggered
- Delaying responses to applicants of minority groups vs. applicants from white males

ELEMENTS OF UDAAP

Deceptive:

1. The representation, omission, act, or practice misleads or is likely to mislead the consumer;
2. The consumer’s interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and
3. The misleading representation, omission, act, or practice is material.

DECEPTIVE

Deceptive – 1: The representation, omission, act, or practice misleads or is likely to mislead the consumer.

Deception occurs when the practice is likely to mislead, not only when it has misled.

- Must be evaluated in context to determine the net impression
- Omission of information needed may be deceptive.

Four P's Test:

- Is the statement **prominent** enough for the consumer to notice?
- Is the information **presented** in an easy-to-understand format that does not contradict other information in the package and at a time when the consumer's attention is not distracted elsewhere?
- Is the **placement** of the information in a location where consumers can be expected to see or hear?
- Finally, is the information in close **proximity** to the claim it qualifies?

DECEPTIVE

Deceptive – 2: The consumer's interpretation of the representation, omission, act, or practice is reasonable under the circumstances.

What interpretation is expected of a reasonable member of the target audience?

- Older Americans
- Young People
- Financially distressed populations

Remember, we are financial professionals with industry knowledge - the average consumer is not.

1. If a significant minority is misled, it may be deceptive

2. Exaggerations, "puffery", and superlatives are not inherently deceptive, if not taken seriously by a reasonable consumer

DECEPTIVE

Deceptive – 3: The misleading representation, omission, act, or practice is material

"Material" means it is likely to affect the consumer's choice or conduct regarding the product or service. Think of it as important information, ie:

- *Central characteristics of a product or service*
- *Costs, benefits, restrictions on use*
- *Knowingly false information*
- *Omissions when the information is necessary to evaluate the product or service.*

DECEPTIVE

Deceptive - Examples

- Blurring or flashing important terms and conditions on a screen or ad so they may not be read
- Misspellings left uncorrected that lead to misunderstanding of the terms
- Mixing terms and features of different products that mislead the consumer
- Presenting highly favorable rates that are either not actually available or obscuring the requirements to receive them
- Opening accounts not requested by a consumer to pad profits or performance
- Presenting information to appear appealing but not to be accurate “Win this Car!” but the image is a carefully posed photo of a toy, not a vehicle.

ELEMENTS OF UDAAP

Abusive:

1. Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or;

2. 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 its interests** 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.

ABUSIVE

Abusive – 1: Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service.

Less defined due to its relative newness in the regulation, there are explicitly included activities:

- Intentional action which causes harm
- Deliberate manipulation of policy for gain or to cause harm
- Misuse of power, (ie: economic or informational) over those harmed

ABUSIVE

Abusive – 2: Takes Unreasonable Advantage of: a lack of understanding, inability of the consumer to protect its interests or reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

- The recent Policy Statement indicates this boils down to two actions:
  - **Obscuring important features** of a product or service, or
  - Leveraging certain circumstances to **take an unreasonable advantage**.

No substantial injury is necessary for there to be liability for abusive acts or practices.

Just doing it is bad enough because it distorts or harms markets through its presence.

ABUSIVE

A policy statement to define Abusive acts or practices was issued in 2020 and rescinded in 2021 by the CFPB, with an updated policy statement just released on April 3rd, 2023.

Abusive - Examples

Collections practices that include verbally aggressive, threatening behavior .

Promoting a service as matching consumers to the best lender for their needs, but it instead steers them to high-cost lenders, creating more profit for the referring entity.

Describing a discussion as “not an application” to the consumer but pulling their credit without their knowledge (which may decrease their score) to inflate application volume.

Charging fees, transferring funds, or altering accounts in ways that cost consumers more money without their knowledge.

REAL WORLD UDAAP

Complaints

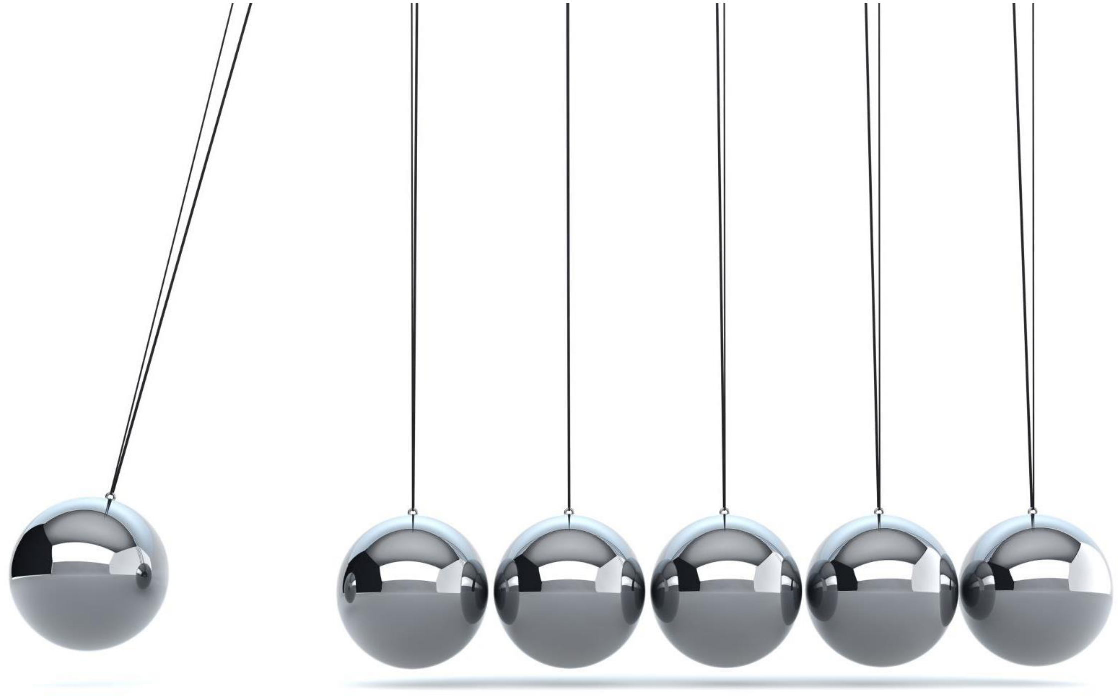
Identifying UDAAP events

External influences on Regulation

Re-interpretations of UDAAP & The Fee Focus

Enforcement Actions

Continuing Evolution



COMPLAINTS

Effective **Complaint Management** is key to flagging UDAAP issues!

- **Tracking** - You expect what you inspect. If you don't track each complaint, you have no opportunity to analyze the impact or root cause
- **Great Note-Taking** – Who, What, When, Where and How did it happen?
- **Escalation** – Know when it's time to call in the big guns and have a system to escalate based on easily understood criteria
- **Trend/Pattern Review** – Are you seeing more complaints on credit cards? A spike at one branch? A rash of billpayer issues? Complaints about ads? Eyeball complaint history month over month, to identify the root cause. Is it a UDAAP issue?
- **Record Keeping** - Make sure you keep correspondence, email, notes files, and the decision making in any higher risk complaints addressed so you can evidence you handled them appropriately.

IDENTIFYING UDAAPS

Familiarize yourself with the elements of UDAAP and look for them!

Do you perform a UDAAP Risk Assessment?

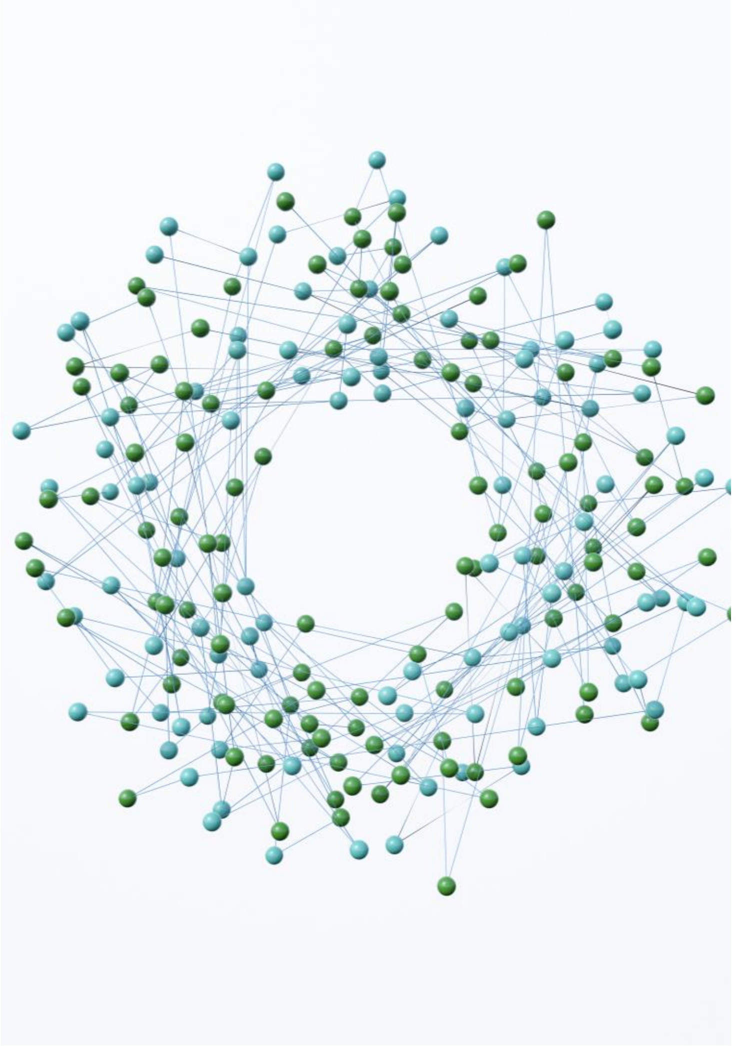
Are unfair, deceptive, and abusive acts or practices a built-in part of your assessments, reviews, or approvals of:

- Marketing and Advertising (material, channel, images)
- New Products and Services
- Fee Structures, Relationship Programs, Referral Programs, Incentives
- Vendor Selection, Review, and Performance
- Complaint tracking, trending, and review
- Position relative to the market, regulatory guidance, or commentary

EXTERNAL INFLUENCES ON REGULATION

- Administration changes
- Public policy
- Consumer and public pressures
- Litigation and major market events
- “Viral” stories of customer experience complaints
- Individual Regulator priorities

RE-INTERPRETATIONS



RE-INTERPRETATIONS

Prior administration: Deregulation focused, free market focused, enforcement actions reduced.

Current administration: Proactive, enforcement action encouraged, consumer-focused, fairness focused.

- **June 2021** – HUD rescinded 2020 Fair Housing Disparate Impact rule
- **March 2021** – CFPB rescinded policy statement on Abusive standards under UDAAP which restricted when the agency would take enforcement action
- **February 2023** – Presidential Junk Fee “Crackdown” initiated, directive to pass “Junk Fee Prevention Act”.

RE-INTERPRETATIONS

February 2023 – Presidential Junk Fee “Crackdown” published. Also, a directive to pass a “Junk Fee Prevention Act” was issued. However, this has not yet been passed, and the updated statements and focus by regulators are not yet in statute or regulation.

However… This does not mean you want to disregard this shift in approach! Changes are here for many common fees:

- Overdraft/NSF
- Representment
- Returned Deposit Item

RE-INTERPRETATIONS

Consumer Financial Protection Circulars

A new, non-regulation tool, this publication is aimed at the prudential regulators: FDIC, OCC, NCUA, and Federal Reserve. It is intended to set the tone and focus for regulators at exam time – and may give you insight into their approach when you have them on site.

All circulars are available to the public here: Consumer Financial Protection Circulars | Consumer Financial Protection Bureau (consumerfinance.gov)

Two of the new circulars published since May 2022 address UDAAP related issues!

RE-INTERPRETATIONS

Consumer Financial Protection Circulars – UDAAP and Overdraft Fees

October, 2022

Can the assessment of overdraft fees constitute an unfair act or practice under the Consumer Financial Protection Act (CFPA), even if the entity complies with the Truth in Lending Act (TILA) and Regulation Z, and the Electronic Fund Transfer Act (EFTA) and Regulation E?"

Yes! *- Overdraft fees assessed by financial institutions on transactions that a consumer would not reasonably anticipate are* ***likely unfair****.*

- "Authorize positive, settle negative (APSN)" fees are the key target here.
- How does an APSN fee hit the UDAAP Threshold?

RE-INTERPRETATIONS

Consumer Financial Protection Circulars – UDAAP and Overdraft Fees

The Analysis states that consumers have a limited understanding of the mechanisms and processes that depository institutions use to determine the balance and are *likely to rely on the available balance* at the time of a transaction. The language in the analysis reflects the language in UDAAP:

- Consumers *cannot be reasonably expected to understand* and work around industry balance calculations, ordering of transactions, prior deposits' treatment, etc. in order to avoid an overdraft.

- This makes it difficult for a consumer to *reasonably avoid* Approve Positive Settle Negative triggered fees (*an injury*), without *countervailing benefit* to the consumer or competition. This makes APSN fees an unfair practice under UDAAP.

RE-INTERPRETATIONS

Representments

In August of 2022, the FDIC published supervisory guidance on the use of multiple re-presentment fees: FDIC: FIL-40-2022: Supervisory Guidance on Multiple Re-Presentment NSF Fees

These are NSF fees charged when an ACH transaction is presented for payment but is declined and is then re-submitted to attempt to collect the payment. The ACH transaction may be re-submitted (re-presented) multiple times.

The guidance states this poses "elevated risk of violations of law and harm to consumers".

RE-INTERPRETATIONS

Representments

In many cases, the disclosures provided on these accounts *did not specifically state* that re-presentment would result in the *same NSF fee being applied* as when the transaction was first presented. This information is considered *material* under UDAAP and its absence interferes with decision making.

It is also difficult for a consumer to anticipate or know that a re-presentment will be attempted, as much of this process is automated or outsourced and obscure to consumers. This makes it more likely the injury will occur and *limits consumer ability to avoid the injury.*

With no countervailing benefit to consumers or competition, this appears to hit the UDAAP threshold as well.

RE-INTERPRETATIONS

Supervisory Highlights – UDAAP and Returned Deposit Item Fees

Another resource, the "Supervisory Highlights" recaps issues identified by the CFPB in recent months and summarized for the industry.

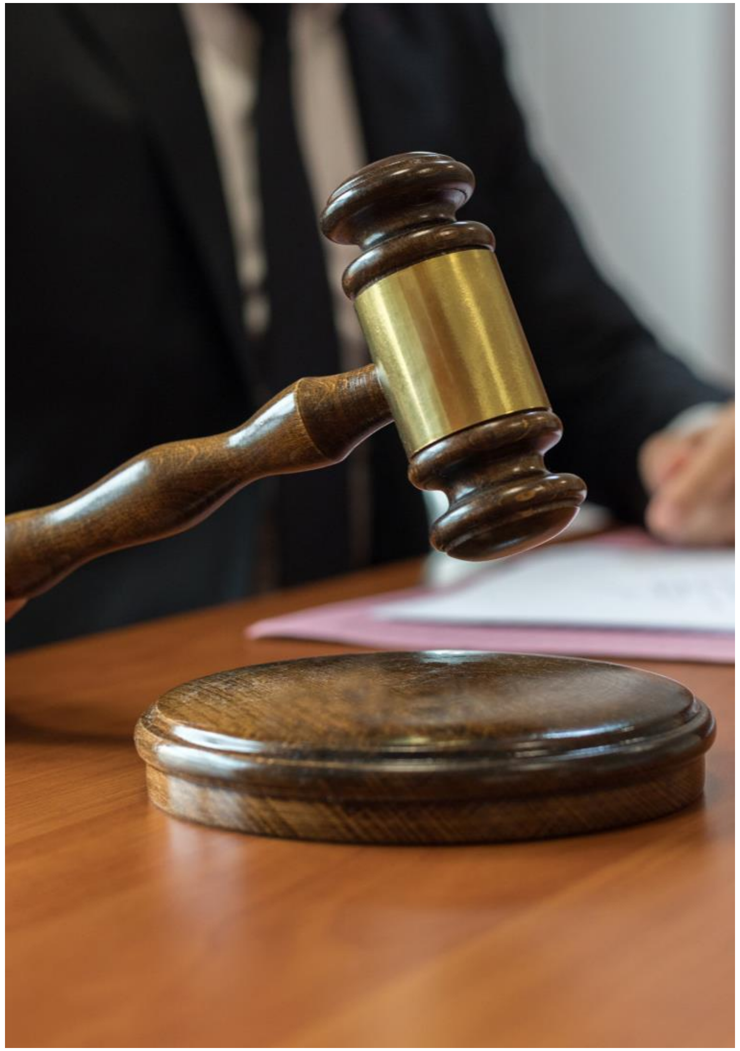
In November 2022, the CFPB stated that charging Returned Deposit Item fees to all returned transactions *without considering patterns of behavior or circumstances* is likely unfair.

- The consumer has no control over whether a deposited item will be returned and generally cannot easily see if funds are sufficient for it to clear, thus *cannot easily avoid it.*
- These fees on top of any NSF fees which may be triggered by the item can accumulate to a total of $47 (per CFPB calculations) per returned item (an injury).
- There is no countervailing benefit to consumers or competition evident

The practice is considered unfair when applied universally – has your institution evaluated these fees?

Bulletin 2022-06: Unfair Returned Deposited Item Fee Assessment Practices (consumerfinance.gov)

ENFORCEMENT ACTIONS



ENFORCEMENT ACTIONS

In one case in 2021, the CFPB determined that bank employees materially interfered with consumers' ability to understand the terms and conditions of the service by:

1. Not providing written disclosures before obtaining the consumers' oral assent to opt-in; and by
2. Advertising the overdraft service as a "free" part of the account package rather than explaining the full costs of the service.

An added factor was that written ***disclosures*** presented to the consumer were ***pre-checked with the option to accept the service***. This directly interfered with the customers' understanding of the terms and conditions, as it appeared that the pre-checked option could not be changed to opt-out.

This is a great example of a regulatory violation of one rule (Regulation E Opt-In requirements) also violating another - UDAAP!

ENFORCEMENT ACTIONS

In October 2022, a nonbank remittance transfer provider (ie: Wires) was penalized for practices that violated the EFTA (Regulation E) rules around several requirements: refunds when required to correct errors, cancellation rights, disclosures, terms, font sizes, complaint and error resolution policies and document retention. These also hit the UDAAP threshold.

- Failure to provide required disclosures, accurate terms information, and notice of rights interferes with the consumers’ ability to make a decision
- Failure to provide refunds in the course of error resolution is an injury – added cost
- All of the practices above harmed consumers and had no countervailing benefit to consumers or competition, thus, a UDAAP violation.

The provider was required to provide direct **compensation of $30,000** to harmed consumers and pay a **civil money penalty of $700,000**. The company must also take measures to ensure future compliance.

ENFORCEMENT ACTIONS

In December 2022, a consent order was entered with a large national bank over conduct including: misapplied auto loan payments, improper fees and interest, illegal repossession of borrower vehicles, surprise overdraft fees and freezing of accounts using a “faulty” automated fraud detection system.

- Failure to adhere to the disclosed terms and conditions of the accounts through misapplication of payments and fees and interest not agreed to.
- The added charges and misapplied payments resulted in higher costs and negative impact to consumers’ credit reports.
- Surprise overdraft fees are also inherently considered unfair under current guidance
- All of the practices above harmed consumers and had no countervailing benefit to consumers or competition, thus, a UDAAP violation.

The bank must pay more than **$2 billion in compensation to harmed consumers** and a **record $1.7 billion civil money penalty** as well as developing a plan to correct the issues and effectively monitor compliance going forward.

UDAAP EVOLUTION

UDAAP is continuing to undergo a *transformation*, a very deliberate effort to make the regulatory frameworks and actions taken more friendly to consumers and skeptical of charges and practices without clear benefit to consumers.

With the inclusion of discrimination as a UDAAP violation, re-evaluation of the fairness of common industry fees, and guidance issued through non-rulemaking processes, every part of banking is affected.

ACTION STEPS

- Monitor regulatory guidance, enforcement actions, examination trends for impact on your institution.
- Periodically Evaluate products, services, and fees for UDAAP risk under new interpretations.
- Manage your complaints effectively.
- Take proactive steps based on your unique situation and risks identified in other reviews.
- Document your reasoning and decisions whether changing processes or keeping fees and retain that for exam time.

THANK YOU FOR YOUR TIME!