LAWDESK

UNFAIR, DECEPTIVE, AND ABUSIVE ACTS AND PRACTICES

TRAINING

Unfair, Deceptive, and Abusive Acts and Practices

UDAAP

The purpose of this training is to familiarize you with principles related to *unfair, deceptive, and abusive acts and practices* ("UDAAP").

After completing this course, you will be better prepared to:

- Understand the differences among unfair, deceptive, and abusive acts and practices.
- Identify examples of unfair, deceptive, and abusive acts and practices.
- Prevent unfair, deceptive, and abusive acts and practices in your day-to-day activities.
- Understand non-compliance consequences.

Background & Purpose

Consumer protection
Is the root of the laws targeting UDAAPs, which can cause significant financial injury to consumers, erode consumer confidence, and undermine the financial marketplace. With a constant stream of product solicitations, consumers have a tough time making well-informed decisions when applying for credit or making purchases. They fall victim to misleading information and suffer financial harm as a result.

Sources of UDAAP Law

Prohibitions on unfair, deceptive, or abusive acts or practices are found in the *Federal Trade Commission Act* ("FTC Act"), the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank"), Regulation AA, as well as in state laws. These sources of UDAAP law can be used to bring enforcement actions or litigation against a financial institution.

FTC Act
Section 5 of the FTC Act prohibits *unfair or deceptive acts or practices* ("UDAP").

Dodd-Frank Act
Dodd-Frank prohibits *unfair, deceptive, or abusive acts or practices* ("UDAAP"). The Dodd-Frank Act was created to bring about financial regulatory reform as a result of the financial crisis in 2007-2010. Dodd-Frank created a new regulatory body, the Consumer Financial Protection Bureau ("CFPB"). The CFPB has rule-making, supervisory and enforcement authority to prevent UDAAP related activities.

Conduct is considered "unfair" or "deceptive" under Dodd-Frank in the same manner in which such conduct is considered unfair or deceptive under Section 5 of the FTC Act. The difference is the additional "A" referring to the "**Abusive**" element in UDAAP that Dodd-Frank adds.

Unfair Acts or Practices

An act or practice is unfair when all of the following are true:

- **It causes or is likely to cause substantial injury, usually monetary, to consumers**. Element 1: An act or practice is unfair when it causes or is likely to cause substantial injury, usually monetary, to consumers. Substantial injury usually involves **monetary harm**. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. For **example**, in determining whether it is unfair to treat a payment as late when consumers have not been provided with a reasonable time to pay, the regulatory agencies focus on the harm that consumers experience from the fees imposed when a payment is received after the due date. The harm that consumers experience from these late fees is widespread, therefore, the agencies determined that failure to provide a reasonable amount of time to make a payment caused substantial monetary injury to a significant number of consumers.

- **It cannot be reasonably avoided by consumers**. Element 2: An act or practice is unfair when consumers cannot reasonably avoid the injury. An act or practice is unfair if it interferes with a consumer's ability to **effectively make decisions**. For **example**, this may occur if **material information about a product, such as pricing, is withheld** from a consumer until after the purchase is made, so that the consumer cannot reasonably avoid the injury. Because consumers should be able to analyze the available alternatives, choose those that are most attractive to them, and avoid those that are inadequate or unacceptable. The question to ask yourself is whether an act or practice unreasonably impairs the consumer's ability to make an informed decision, not whether the consumer could have made a wiser decision.

- **The resulting injury is not outweighed by benefits to consumers or competition.** Element 3: An act or practice is unfair when the resulting injury is not outweighed by benefits to consumers or competition. To be unfair, the injury must not be outweighed by any offsetting benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a larger availability of products and services. Unfair acts or practices injure both consumers and competition because consumers who would have otherwise selected a competitor's product or service, are wrongly directed by the unfair act or practice.

Examples of Unfairness

The following examples of unfair conduct are based on actual enforcement actions:

- **Dishonoring credit card convenience checks without notice**. A credit card issuer mailed convenience checks with stated credit limits and expiration dates to customers. For a significant percentage of consumers, the issuer reduced their credit lines after the checks were presented, and then the issuer dishonored the consumers' checks. As a result of this practice, the issuer was fined $250,000.
    - **Substantial Injury -** Because the card issuer reduced their credit lines, consumers paid returned-check fees and may have experienced a negative impact on their credit histories.
    - **Not Reasonably Avoidable -** Consumers reasonably relied on their existing credit limits and expiration dates on the checks when deciding to use them for a payment. Consumers received no notice that the checks they used were being dishonored until the checks bounced. Therefore, the consumers could not reasonably have avoided the injury.
    - **Not Outweighed by Benefits -** The card issuer later reduced credit limits based on credit reviews. Based on the particular facts involved in the case, the harm to consumers from the dishonored convenience checks outweighed any benefit of using new credit reviews.

- **Refusing to release lien after consumer makes final payment on a mortgage**. Regulators brought an enforcement action against a mortgage company that repeatedly failed to release liens after consumers fully paid the amount due on their mortgages.
    - **Substantial Injury** - Consumer's sustained economic injury when the mortgage servicer did not release the liens on their properties after the consumers had repaid the total amount due on the mortgages and refused to pay additional fees.
    - **Not Reasonably Avoidable** - Consumers had no way to know in advance of obtaining the loan that the mortgage servicer would not release the lien after full payment. Moreover, consumers generally cannot avoid the harm caused by an improper practice of a mortgage servicer because the servicer is chosen by the owner of the loan, not the borrower. Thus, consumers cannot choose their loan servicer and cannot change loan servicers when they are dissatisfied with the quality of the loan servicing.
    - **Not Outweighed by Benefits** - Benefits to competition or consumers did not result from the servicer's alleged failure to appropriately service the mortgage loan and release the lien promptly.

- **Processing payments for companies engaged in fraudulent activities**. Regulators brought an enforcement action in a case involving a bank that maintained deposit account relations with telemarketers and payment processors. The telemarketers regularly deposited large numbers of remotely created checks drawn against consumers' accounts. A large percentage of the checks were not authorized by consumers. The bank failed to establish appropriate policies and procedures to prevent, detect, or remedy such activities.

- **Substantial Injury** - Consumers lost money from fraudulent checks created remotely and drawn against their accounts.

- **Not Reasonably Avoidable** - Consumers could not avoid the harm because the harm resulted principally from transactions to which the consumers had not consented.

- **Not Outweighed by Benefits** - The cost to the bank of establishing a minimum level of due diligence, monitoring, and response procedures sufficient to remedy the problem would have been far less than the amount of injury to consumers that resulted from the bank's avoiding those costs.

Deceptive Acts or Practices

A representation, omission, act or practice is deceptive when:

- **The representation, omission, or practice misleads or is likely to mislead the consumer**. Element 1: An act or practice may be deceptive when the representation, omission, or practice misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be deceptive if it is likely to mislead consumers.

- **The consumer's interpretation of the representation, omission, or practice is reasonable under the circumstances**. Element 2: An act or practice may be deceptive when the consumer's interpretation of or reaction to the representation, omission, act, or practice is reasonable under the circumstances. In other words, whether an act or practice is deceptive depends on how a reasonable member of the target audience would interpret the representation. Representations or marketing practices that target a specific audience, such as the elderly, young people, or financially distressed consumers, must be reviewed from the point of view of a reasonable member of that group.

- **The misleading representation, omission, or practice is material**. Element 3: An act or practice may be deceptive when the misleading representation, omission, or practice is material. The representation, omission, act, or practice is material if it is likely to affect a consumer's choice of, or conduct regarding, the product or service. Any information that is important to consumers is considered material. Below are some categories of information that are presumed to be material

  - Costs, benefits, or restrictions on the use or availability.
  - Express claims made with respect to a financial product or service.
  - Implied claims when evidence shows that the institution intended to make the claim (even though intent to deceive is not necessary for deception to exist).
  - Claims made with knowledge that they are false.
  - Omissions of information where the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service.

Examples of Deception

The following examples of deceptive conduct are based on actual enforcement actions:

- **Inadequate disclosure of material lease terms in television advertising**. A vehicle leasing company advertises on television that consumers can lease vehicles for "$0 down" when advertising a monthly lease payment. At the end of the commercial, unreadable fine print is flashed on the screen for consumers to attempt to read. This flash of fine print discloses costs of at least $1,000.

  - **Representation or Omission Likely to Mislead** - The television advertisements featured prominent statements of "$0 down" at lease signing. The advertisement also contained, at the bottom of the screen, unreadable fine print in which various disclosures required by

Regulation M (the Consumer Leasing Act) were made. The disclosures were inadequate because they were not clear, prominent, or audible to consumers.

- **Reasonable Consumer Perspective** - A reasonable consumer would believe that he or she did not have to put any money down and that all he or she owed was the regular monthly payment.

- **Material Representation** - The stated "$0 down" plus the low monthly lease payment were material representations to consumers. The fact that the additional, material costs were disclosed at signing of the lease did not cure the deceptive failure to disclose in the television advertising.

- **Misrepresentation about loan terms.** A mortgage broker advertised mortgage refinance loans at "3.5% fixed payment 30-year loan" or "3.5% fixed payment for 30 years," implying that the offer was for a 30-year loan with a 3.5% fixed interest rate. Regulators alleged, however, that the broker offered adjustable rate mortgages (ARMs) with an option to pay various amounts, including a minimum monthly payment that represented only a portion of the required interest. As a result, unpaid interest was added to the principal of the loan, resulting in negative amortization.

  - **Practice Likely to Mislead -** The advertisements were misleading because they compared payments on a mortgage that fully amortized to payments on a non-amortizing loan with payments that increased after the first year. In addition, the broker provided Truth in Lending Act (TILA) disclosures that misstated the annual percentage rate (APR) and that failed to state that the loan was a variable rate loan.

  - **Reasonable Consumer Perspective** - It was reasonable for consumers to believe that they would obtain fixed-rate mortgages, based on the representations.

  - **Material Representation -** The representations were material because consumers relied on them when making the decision to refinance their fully amortizing 30-year fixed loans. As a result, the consumers ended up with adjustable rate mortgages that would negatively amortize if they made payments at the stated 3.5% payment rate.

Abusive Acts or Practices

In addition to unfair and deceptive conduct, abusive conduct is also prohibited. An act or practice is considered abusive if:

- **It materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service. Element 1:** An act or practice is considered abusive if it materially interferes with the consumer's ability to understand a term or condition of a consumer financial product or service. If in doubt, ask yourself "Is the consumer able to make an **educated decision** based the disclosures and explanations of material information provided to them?" If the response is "No", consider revising the disclosures or provide additional information. Otherwise, the disclosures may be considered too vague or complicated for the consumer to understand and the act or practice may be viewed as abusive.

- **It takes unreasonable advantage of the consumer. Element 2:** An act or practice is considered abusive if it takes **unreasonable advantage** of the consumer's: (1) Lack of understanding of the material risks, costs, or conditions of the product or service; (2) Inability to protect his or her interests in selecting or using a consumer financial product or service; or (3) Reliance on a covered person to act in the interests of the consumer.

The following are examples of a violation of the abusive element of UDAAP.

Anytown Bank provides elderly consumers with disclosures in **complicated jargon and pressures them** into unfavorable contractual loan terms.

XYZ Finance Company's loan officers intentionally **fail to provide clear disclosures and explanations of the terms and fees** associated with loans to consumers who have a limited understanding of English and mortgage products. As a result, these consumers are unable to make educated decisions and are given loans with high interest rates, fees, and prepayment penalties, although they qualify for more favorable terms.

John is a mortgage lender and distributes fliers advertising home refinance loans to a neighborhood consisting of low-income housing. He knows that the majority of the homeowners within this neighborhood have special subsidized mortgages through a government program with favorable terms. John represents to applicants that they should trust him and that he will ensure that they receive a loan with all of the benefits of the current loan, but with a lower rate.

The flier generates several loan applications. The only way that the mortgage lender can beat an applicant's current rate is to offer the following terms:

New Terms	Current Terms
Rate: 3.0% fixed	**Rate: 4.0% fixed**
Term: 5 year balloon (30-year amortization)	**Term: 30 year**
Prepayment penalty: Yes	**Prepayment penalty: None**

The new loan terms results in the loss of beneficial loan terms and may be considered an abusive practice. This is especially true when the new loan terms involve "exotic" features or even standard practices, such as certain variable rate features and balloon payments. An act or practice is considered abusive if: it materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product; or if it **takes unreasonable advantage of: a lack of understanding** on the part of the consumer of the material risks, costs, or conditions of the product; the inability of the consumer to protect his or her interests in selecting a consumer financial product; or the **reasonable reliance by the consumer on a covered person** to act in the interests of the consumer.

Examples of UDAAP

- Loan officers encourage new college students to obtain personal loans with low introductory rates to pay for tuition. These personal loans have substantially high late fees, prepayment penalties, and interest rates. Since many of these college students do not have any credit experience, they are unfamiliar with the types of fees that can increase the cost of credit. The loan officers take advantage of the students by befriending them and then failing to clearly disclose the fees and interest rates. **This is Abusive**.

- A credit card issuer approves a secured credit card application on the condition that the initial security deposit is charged to the card and fails to disclose the available credit would be reduced by doing so. After the security deposit, consumers with a credit line of $300 have only $50 in credit available. **This is Deceptive**.

- A bank makes representations in an advertisement that certain deposit products are suitable for consumers who mishandled their credit or bank account in the past, but omits disclosure of the overdraft fees associated with the account, which makes the account unsuitable for such consumers. **This is Deceptive**.

- A bank provides account disclosures stating a daily limit on overdrafts and overdraft transaction fees but does not adhere to those limits. **This is Deceptive**.

- A bank fails to impose a reasonable limit on aggregate overdraft fees assessed under an automatic-enrollment overdraft program, resulting in consumers paying more in overdraft fees in a given month than the overdraft limit on their accounts or their average daily account balance. **This is Unfair**.

- Mailing billing statements to consumers and not providing a reasonable amount of time to make a payment without being assessed a late fee. **This is Unfair**.

- A credit card issuer increases the APR on the accounts of small business owners and professionals who had neither exceeded their credit limits nor were delinquent on payments. The institution failed to adequately notify accountholders that their APR would increase, or to adequately notify them of the amount of the increase, the reason for the increase, the procedures to opt-out, and the consequences of an opt-out. **This is Unfair**.

- Loan officers obtain loans with high interest rates, fees, and prepayment penalties for consumers with a limited understanding of English. These consumers relied on and trusted that the loan officer would fit them with the most appropriate mortgage and would clearly and thoroughly explain the terms of the mortgage and the associated fees. However, the loan officers did not provide clear disclosures and explanations of the terms and fees associated with the loan in the consumers' native language, which prevented them from making educated decisions. **This is Abusive**.

- Company's privacy policy claimed: "We take our responsibility to protect the privacy and confidentiality of customer information very seriously. We maintain physical, electronic, and procedural safeguards that comply with federal standards to store and secure information about you from unauthorized access, alteration and destruction. Our control policies, for example, authorize access to customer information only by individuals who need access to do their work." However, the Company failed to provide reasonable security to protect sensitive customer data, making it vulnerable by allowing a third-party contractor to access the data without taking reasonable steps to protect it. A hacker compromised the data by breaking into the third-party contractor home computer, obtaining the Company's credentials, and using them to access hundreds of consumer reports. **This is Unfair.**

Avoiding UDAAP

UDAAP applies across the enterprise and affects all aspects of the product life cycle. Virtually all operational areas at the Company are vulnerable to noncompliance with UDAAP requirements.

Unfair - "Does the act or practice hinder a consumer's decision-making?"

- Failure to reasonably limit aggregate overdraft fees.
- Dishonoring convenience checks without notice.
- Increasing the annual percentage rate ("APR") without giving notice or reason.
- Failure to protect consumer's personal information.
- Failure to protect consumers from financial abuse.

Deceptive - "4 Ps = Prominent, Presented, Placement and Proximity of information"

- Making misleading cost or price claims.
- Offering to provide a product or service that is not in fact available.
- Using bait and switch techniques.
- Omitting material limitations or conditions from an offer.
- Failing to provide the promised services.
- Omitting information that you knew or should have known the consumer needed to evaluate the product or service.

Abusive - "Is the consumer able to make an educated decision?"

- Providing **disclosures with complicated jargon**.
- Explaining terms or conditions in a vague or complicated manner.
- **Pressuring or convincing vulnerable individuals**, such as the elderly, the financially unsophisticated, and non-English speaking consumers, to enter into unfavorable terms.

Marketing & Disclosures

Review all marketing materials and disclosures to identify any potential UDAAP concerns. Marketing materials and disclosures should contain information that is:

(1) Factual:

- Ensure that all representations are factually based.

(2) Clear, Prominent & Accurate:

- Ensure that all materials describe clearly, prominently, and accurately:
    - Costs, benefits, and other material terms of the products or services being offered.
    - Related products or services being offered either as an option or required to obtain certain terms.
    - Material limitations or conditions on the terms or availability of products and services, such as:
    - Time limitations for favorable rates,
    - Promotional features,
    - Expiration dates,
    - Prerequisites for obtaining particular products or services, or
    - Conditions for canceling services.

- Ensure that all materials clearly and prominently disclose the fees, penalties, and other charges that may be imposed and the reason for imposition.

- Ensure that products that combine features or terms have not been combined in a manner that can increase the difficultly of consumer understanding of the overall costs or risks of the product and the potential harm to the consumer associated with the product.

(3) Targeted Properly:

- Ensure that the products or services are targeted to the proper audience or population group by tailoring the marketing, disclosures, costs, benefits, availability, terms, and other materials in language that can be understood by the consumers.

(4) Terms:

- Draw the customer's attention to key terms, including limitations and conditions that are important to enable the consumer to make an informed decision.
- Avoid advertising terms that are generally not available to the typical targeted consumer.
- Ensure that materials do not misrepresent costs, conditions, limitations, or other terms either affirmatively or by omission.

Originations & Account Opening

UDAAP violations may also exist in the beginning stages of a transaction. Consider whether consumers are actually receiving the terms or services advertised. For example, is the loan that is being offered to a consumer actually available on the terms advertised?

(1) Products:

- Ensure that products do not depend on penalty or back-end fees rather than upfront fees for profitability.
- Avoid products that have a high rate of re-pricing or other changes in terms.
- Avoid imposing fees or other costs on a consumer for obtaining information about his or her account.
- Avoid compensation arrangements that create UDAAPs. For example, reward employees with bonuses or commission for providing quality customer service instead of volume or dollar amount of sales.
- Ensure that consumers are charged only for products and services that they specifically agree to, such as insurance or credit protection programs.

(2) Terms or Services:

- Ensure that consumers are reasonably able to obtain the products and services, including interest rates or rewards, as represented by the Company.
- Ensure that consumers receive the specific product or service that they request.
- Ensure that counter-offers clearly, prominently, and accurately explain the differences between the original product or services requested and the one being offered.
- Avoid practices that are inconsistent with stated policies, procedures, or account disclosures.
- Ensure that agreements clearly inform customers of agreement provisions that permit changes in terms and condition of the product or service.

(3) Credit:

- Ensure that the available credit is sufficient to allow the consumer to use the product as advertised and disclosed to the consumer.
- Ensure that fees and charges typically imposed on the average targeted customer, both initially and throughout the term of the loan, remain in a range that does not prevent the availability of credit.

Servicing

UDAAP violations do not just occur in the advertising and in the beginning stages of the transaction. UDAAP violations may exist throughout the entire servicing process.

(1) Payments:

- Ensure that payments are posted and credited in a timely manner.
- Do not represent to consumers that they may pay less than the minimum amount without clearly and prominently disclosing any fees associated with paying the reduced amount.

(2) Periodic Statements:

- Disclose fees and other charges in a manner that is not misleading.
- Mail periodic statements in time to provide the consumer with ample opportunity to avoid late payments.

(3) Customer Service:

- Listen to and analyze customers' issues. Ask the basic open questions… Who?… What?… When?… Where?… How?
- Respond to customer's requests in a timely manner.
- Do not impose penalties on a customer when he or she terminates the relationship.

(4) Failure to Act:

the Company can be held liable if it knowingly permits or is willfully blind and does nothing to stop UDAAP violations from occurring. This liability extends to UDAAP perpetrated by the Company's customers. For example, if a customer uses an account to facilitate UDAAP, the Company can be held liable for its customer's activities if it does nothing to stop them.

(5) Complaints:

Consumer complaints play a key role in detecting UDAAP. Identify, track and resolve the root cause of complaints:

- Stating that consumers do not understand the terms of a product or service.
- Against subsidiaries, affiliates and third parties regarding the products and services offered through the Company or the Company's name.

- Filed with the Better Business Bureau, State Attorneys General, and Federal and State agencies, or on-line consumer complaint boards.
- Requesting refunds or charge-backs for the product or service.

(6) Collections:

- Ensure compliance with the standards under *Fair Debt Collections Practices Act* ("FDCPA") to prevent abusive, deceptive, or unfair debt collection practices.
- Clearly indicate to consumers the purpose of the call when collecting a debt.
- Do not disclose the existence of a consumer's debt to the public without the consumer's consent.
- Avoid repetitive telephone calls that annoy, abuse, or harass any person at the number called.
- Create detailed policies and monitor systems to prevent UDAAP.
- Effectively respond to all consumer calls.
- Apply collection policies and procedures uniformly.

(7) Service Providers:

To avoid being held liable for UDAAPs committed by service providers (vendors):

- Monitor activities of the service providers for potential UDAAP concerns relating to marketing, disclosures and all aspects of servicing.
- Avoid compensation arrangements that create UDAAP, by, for example, compensating service providers based on the number of late fees generated.

Best Practices

Here are some best practices that can help you avoid UDAAPs:

- Develop and implement initial and ongoing training.
- Develop and implement UDAAP policies and procedures.
- Develop internal monitoring and auditing processes to monitor and evaluate all aspects of the institution for UDAAP issues.
- Evaluate compensation programs for employees and service providers.
- Monitor, track and analyze customer complaints.
- Review all advertising and promotional materials before publication, including the institution's web site.
- Review all disclosures and agreements before use and on an ongoing basis to ensure that they have been updated.
- Review customer service and telemarketing scripts.
- Review new products and changes in terms and conditions of existing products.
- Review recordings of customer service and collections calls.
- Track high volumes of charge-backs or refunds for a product or service.

Noncompliance Consequences

Violations of laws and regulations can also be UDAAP violations. This means that violations of, for example, the *Equal Credit Opportunity Act* (“ECOA”), can result in both ECOA and UDAAP related penalties.

Additionally, you can be in technical compliance with consumer protection laws and regulations, but still violate UDAAP requirements. Here is an example:

An institution used high pressure marketing tactics to sell credit card add-on products to consumers with low credit scores or low credit limits. These add-on products included payment protection plans and credit monitoring. The products themselves complied with applicable consumer protection laws and regulations, but the methods used by the institution in offering the products to the consumers were found to be misleading and deceptive.

For example, in promoting these products, the institution sometimes led consumers to believe that the products would improve their credit scores. In other cases, consumers were led to believe that the products were required in order to activate their card or were wrongfully told that they could cancel the products if they did not like it. Consumers who then tried to cancel the products allegedly had trouble doing so.