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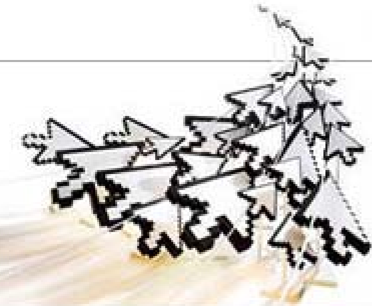
Financial Institution Compliance Update



December 10, 2013

This communication is designed to provide you with quick snapshots and timely perspective on recent regulatory developments.

Unfair, Deceptive, or Abusive Acts or Practices: A Regulation with Many Facets

The phrase "unfair, deceptive or abusive acts or practices" (UDAAP) appears 51 times in the Consumer Financial Protection Bureau's (CFPB) Exam Manual.[1] The CFPB and other Federal financial institution regulators are expanding their focus on UDAAP. As an example, in 2012 and 2013, there were several instances of UDAAP violations being identified by regulators including the high profile Mortgage Servicing Settlement brought against several leading mortgage servicers.

Initially, Section 5 of the Federal Trade Commission (FTC) Act protected consumers against unfair or deceptive acts or practices (UDAP). In July 2010, the Dodd Frank Act (DFA) authorized the CFPB to enforce UDAP and also expanded the scope to include "abusive acts and practices" thereby renaming it UDAAP. Prior to the DFA placing the regulation in the hands of the CFPB, the regulation was monitored by the FTC. By giving UDAAP to the CFPB, the risk of UDAAP related scrutiny by a financial regulator and the finding of a violation has now increased.

While UDAAP laws and regulations state that a bank or nonbank financial institution may not engage in unfair, deceptive or abusive acts or practices, those acts or practices are not clearly defined. This creates an environment of uncertainty for regulated entities. For example, a bank underwent a recent exam in which the examiner asked for proof that all loans were checked against the Department of Defense (DoD) website to ensure the borrower was not a service member for all consumer loans. The bank compliance officer stated that the Service member Civil Relief Act (SCRA) does not require a check for all consumer loans. The examiner responded that

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the SCRA doesn't but if the bank did not check the DoD website prior to foreclosure or repossession, this could be considered "unfair" to the borrower and violate UDAAP law.

Breaking down UDAAP

UDAAP consists of three major components: Unfair Acts or Practices, Deceptive Acts or Practices and Abusive Acts or Practices. The DFA states that unfair, deceptive, or abusive acts and practices can cause significant financial injury to consumers, erode consumer confidence, and undermine the financial marketplace [2] which is why the DFA makes it unlawful for a bank to engage in any of these acts.

The CFPB Exam manual describes an "Unfair Act or Practice" as one that:

- Causes or is likely to cause substantial injury to consumers.
- The injury is not reasonably avoidable by consumers.
- The injury is not outweighed by countervailing benefits to consumers or to competition.

Substantial injury is generally implied to mean monetary harm. This can be in the form of fees or costs and an actual injury is not required, just likely to occur. In August 2012, the FDIC cited Higher One, Inc. and the Bancorp Bank for charging multiple non-sufficient funds (NSF) fee's from a single transaction, allowing NSF fees to continue accruing on accounts remaining in overdrawn status for long periods of time and collecting fees from subsequent deposits.[3]

A "Deceptive Act or Practice" is defined as one where:

- The representation, omission, act or practice misleads or is likely to mislead the consumer.
- The consumer's interpretation of the representation, omission, act, or practice is reasonable under the circumstances.
- The misleading representation, omission, act, or practice is material.

The FTC gives the "four P's" test to help the bank determine whether an act or practice is likely to mislead or not: Prominent, Presented in easy to read format, Placement and Proximity. In February 2013, the FDIC cited United Citizens Bank for deceptive EFT disclosures. The FDIC stated the bank administered more burdensome practices than Regulation E allowed.[4]

The definition of an "Abusive Acts or Practice" is one that:

- Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service.
- Takes unreasonable advantage of:
  - A lack of understanding on the part of the consumer of the material risks, costs or conditions of a product or service.
  - The inability of the consumer to protect its interests in selecting or using a consumer financial product or service.
  - The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.

The Many Facets of UDAAP

UDAAP is far reaching in that it touches nearly every consumer related banking regulation including both deposit and lending regulations. Not only do banks have to be cognizant of their primary regulator, but they also must be conscious of the fact that their state banking authority, state attorney general, the Department of Justice, the Federal Trade Commission, HUD and bank customers can all make UDAAP claims. In fact, in 2012 and 2013 all of the above mentioned have made successful UDAAP cases. The penalties for UDAAP are broad as well. There has been restitution, civil monetary penalties and even CRA implications for UDAAP violations.

Steps your organization should take to avoid UDAAP Pitfalls

There are several ways for the bank to avoid UDAAP violations. Below are suggestions for ensuring the bank does not inadvertently get itself into a UDAAP situation:

1. **Monitor Complaints:** This is likely to be the most telling way of identifying UDAAP issues. Look to see what your customers are saying. Is there a pattern to the complaints? Are customers alleging they don't understand fees or are being unfairly charged? If so, take action. The bank will need to identify the root cause of the complaints and analyze them for UDAAP concerns.

2. **Incorporate UDAAP into the Compliance Risk Assessment:** Whether UDAAP is incorporated into the Bank's overall Risk Assessment or placed into each line of business, the Bank should evaluate the level of risk UDAAP presents.

3. **Training:** Ensure staff, management and the Board is trained extensively on UDAAP. Training should be robust and specific to the job duties of those being trained.

4. **Review Existing and New Products and Services:** Review the disclosures to ensure they coincide with actual practices and system parameters. Also, review fees associated with the product / service being offered to ensure they are fairly being assessed and review marketing material for the product or service to ensure it's not deceptive.

5. **Audit:** Periodically audit each line of business, product or service and marketing materials to ensure any potential UDAAP issues are identified and corrected by the Bank prior to an examination by the regulators.

6. **Monitor Third-Parties:** Monitor third-party contractors to ensure they do not engage in unfair, deceptive, or abusive acts or practices. Ensure third parties are adequately trained and do not create unintended incentive to engage in UDAAP when marketing, originating loans for and / or collecting on behalf of the Bank.

Our conclusion

The focus on UDAAP by regulators is increasing. UDAAP touches every aspect of the banking world and has the potential to include severe penalties for non-compliance. Community banks as well as regional and large national banks are not immune to UDAAP scrutiny. By following the six suggestions above, the Bank can reduce the risk of a UDAAP pitfall and its many facets.

[1]Source: CFPB website, http://www.consumerfinance.gov/guidance/supervision/manual/

[2] Source: Dodd Frank Act, Title X, Subtitle C, Sec. 1036; PL 111-203 (July 21, 2010)

[3] Source: FDIC website, http://www.fdic.gov/news/news/press/2012/pr12092.html

[4] Source: FDIC website, http://www.fdic.gov/news/news/press/2013/pr13023a.html

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