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What Lies Beneath? Exploring Dodd-Frank's Prohibition on Unfair, Deceptive, or Abusive Acts or Practices

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Anyone at all familiar with the consumer financial services industry has some level of understanding of the complexities involved in complying with existing laws and regulations that fall within the ambit of state and federal statutes outlining unfair and deceptive acts or practices (UDAP). The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111-203, signals change for the consumer financial services industry in many areas, not the least of which is the murky statutory and regulatory waters that currently exist with UDAP, and the predictable and unpredictable changes to UDAP as a result of the Dodd-Frank Act. This Article examines UDAP issues, and provides practical solutions to avoid compliance and liability issues as new laws take hold.

The Dodd-Frank Act Is a Game Changer

The current political and regulatory environment for the consumer financial services industry is manifestly pro-consumer. Against this backdrop, Congress passed, and on July 21, 2010 President Obama signed, the Dodd-Frank Act. The Dodd-Frank Act is a massive and impressive piece of legislation. The final version chimes in at 2,319 pages, includes 16 titles, requires approximately 250 new rulemakings by about a dozen federal agencies, and calls for 60 new studies and 90 new reports. In the approximately six months since the Dodd-Frank Act passed, it has already yielded over 1,000 pages of proposed regulations and over 350 pages of final rules.[1] Estimates suggest that when all the dust settles, there will be upwards of 5,000 pages of new regulations.[2] The first wave of rules is, in the words of the American Bankers Associations' Executive Vice President Wayne Abernathy, "a massive burden for any industry to work with."[3]

One stunning example of the game-changing nature of the Dodd-Frank Act is Title X, which gives birth to a new federal regulator—the Bureau of Consumer Financial Protection (Bureau). The Bureau will ultimately have nearly plenary authority over wide swaths of the consumer financial services industry and will contribute substantially to a new regulatory landscape.

With so many new rules and regulations anticipated as a result of the Dodd-Frank Act, one might assume that the necessary and perhaps comforting corollary to all this is that the providers, servicers, and developers of consumer financial products and services will eventually have clear guidance. But will they? Could it be possible that, after the ink dries on thousands and thousands of pages of new statutory and regulatory provisions, consumer financial products and services that comply with everything that has been written could *still* be subject to legitimate challenges by regulators or in the courts?

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The Gulf of UDAAP

If the Dodd-Frank Act is the surface of a new ocean, what lies beneath is a regulatory primordial ooze gurgling out new rules for the financial services industry to comply with. One as yet largely unexplored sector of the Dodd-Frank ocean is the area of unfair, deceptive, or abusive acts or practices (UDAAP)—the Gulf of UDAAP.

Under Title X, it is unlawful for any covered person or service provider (generally speaking, anyone who provides a consumer financial product or service as well as their servicers)[4] to engage in "unfair, deceptive, or abusive acts or practices." The Dodd-Frank Act goes on to give the Bureau power to prevent UDAAP and to issue rules identifying and preventing UDAAP with respect to consumer financial products or services.[5]

Mapping the Gulf of UDAAP

The surface of the Gulf of UDAAP has been mapped to some degree. Specifically, the Dodd-Frank Act defines a couple of key terms: "unfair" and "abusive". An "unfair" act or practice is one that (A) "causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers; and (B) such substantial injury is not outweighed by countervailing benefits to consumers or to competition."[6] In making unfairness determinations, the Dodd-Frank Act permits the Bureau to consider public policy, although it cannot be the principle basis for a finding of unfairness.[7]

An "abusive" act or practice is one that:

> (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) a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; (B) the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.[8]

Congress failed to define "deceptive" under the Dodd-Frank Act.

In order to really understand the potential of the Gulf of UDAAP, it is critical to understand the historical development of the general law on UDAP.

UDAP's Big Bang

There have been laws on the books for many decades addressing UDAP. The Federal Trade Commission Act (FTC Act)—originally enacted almost a century ago—provides that "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce" are unlawful.[9] Commonly referred to as the original UDAP provision, it varies substantively from the Gulf of UDAAP—at least superficially—only in that UDAAP includes the term "abusive," while UDAP does not. Under the FTC Act, the Federal Trade Commission (FTC) was the sole federal regulatory body responsible for enforcing UDAP. However, federally regulated financial institutions, as discussed below, are monitored by prudential regulators.

It is worth noting that there is no private right of action under the UDAP provisions of the FTC Act. Consumer advocates have long held the view that this omission is an unmitigated flaw in the FTC Act. As a response to a perceived need for more consumer protection, over time, each of the several states adopted their own so-called "Little-FTC Acts" which gave consumer attorneys the power to bring actions as private attorneys general.[10] The result is that there are 50 such statutes that are codified and enforced differently from each other and from federal enforcement of the FTC Act.

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Accelerated Application of UDAP and the Rise of Suitability Standards

Prior to the Dodd-Frank Act, the FTC Act required certain of the federal financial institution regulators—the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), the Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA)—to set up consumer affairs divisions responsible for processing and, if appropriate, prosecuting consumer complaints.[11] To address the vagaries of UDAP, the prudential regulators started issuing guidance on UDAP over the last decade.

OCC was first out of the box when, in March 2002, it provided national banks and their operating subsidiaries some definitional parameters for deceptive and unfair practices.[12] FDIC followed suit in May 2002.[13] In March 2004, FRB and FDIC jointly issued guidance to state-chartered banks to address UDAP in areas such as servicing, collections, advertising, and solicitation.[14] For all three releases, the federal regulators borrowed heavily from policy statements issued by FTC in 1980 and 1983.[15] These policy statements defined, respectively, unfairness and deception. While some of the policy pronouncements by the prudential regulators included more guidance than others, regulated financial services providers still did not have a comprehensive understanding of actions that might offend the sensibilities of the UDAP enforcers.

Over the past few years, there have been several significant developments in the application of the amorphous UDAP laws to consumer financial products and services. Perhaps the most prolific will ultimately be the creation of the Gulf of UDAAP by the Dodd-Frank Act. But even before that, regulators and courts at both the state and federal level were churning out rules and decisions illustrating the point made above that, while we can *see* the surface of the Gulf of UDAAP, what lies beneath remains largely unknown.

Nevertheless, one emerging danger in the Gulf of UDAAP is the concept known as suitability. Suitability derives from securities law principles establishing that a securities broker may sell to a buyer only those securities that are suitable to the buyer based on factors such as tax status, appropriate financial means, investment objectives, and experience. While not yet a recognized legal standard in the consumer financial services industry, conceptually, a duty of suitability seems to be lurking behind recent UDAP activity.[16]

Another hazard is the inherent "shifting-sands" nature of UDAP standards. For example, in 2008, the Supreme Judicial Court of Massachusetts upheld a lower court injunction prohibiting a lender from foreclosing on certain sub-prime mortgages without first obtaining court approval. When it enjoined the lender, the lower court found that although sub-prime loans generally may not have been considered unfair at the time they were issued, they could nonetheless be deemed unfair under Massachusetts' UDAP laws at the time the attorney general sought the injunction. The appeals court held that, even though the lower court's fairness determination was made after the fact and with the benefit of hind-sight, the lower court could find the loans to be presumptively unfair.[17] This decision may foreshadow the ability of the UDAAP enforcer (*i.e.*, the Bureau) to challenge conduct that seemingly complies with all existing law (other than UDAAP, of course).

In a similar vein, FRB has issued final UDAP-type rules for mortgages and credit cards. Specifically, in 2008, FRB invoked, for the first time, its authority under the Home Ownership and Equity Protection Act of 1994 (HOEPA) to regulate UDAP by prohibiting certain so-called "stated income" or "no-doc" loans, seemingly as an unfair practice.[18] Enforcement of this rule, which makes a lender's belief of certain representations of its customers an unlawful, unfair practice, will ultimately reside with the Bureau. FRB utilized more UDAP authority in 2009

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to prohibit as unfair longstanding and widespread credit card products (*e.g.*, teaser rates).[19]

When the various UDAP/UDAAP developments are pieced together and placed in the hands of a new regulator charged with the task of protecting consumers from such practices,[20] the implications for the consumer financial services industry are potentially quite profound. It is no stretch, for example, to conclude that the Bureau will incorporate and expand on the already inflating notion of retroactive UDAAP analysis and the perceived regulatory power to eliminate ubiquitous industry practices and products. It is also not a stretch to anticipate more suitability-type scrutiny of consumer financial products and services.

What can consumer financial services companies do to avoid, or at least minimize, the risk that the Gulf of UDAAP will unleash from the depths new, unanticipated regulations that could threaten a business line or create potentially devastating liability?

Five Navigation Tools for the Gulf of UDAAP

Because the law of UDAP/UDAAP is so nebulous, unfortunately, it is virtually impossible to know, let alone eliminate, all potential risks. But all hope is not lost. Financial services companies can and should prepare now for their looming and inevitable journey into the Gulf of UDAAP.

- *Conduct an UDAAP Audit*. Review program and product materials, disclosures, and customer lists for red flags such as a substantial number of customers receiving terms less favorable than those advertised. The audit should include a review of every consumer product and service (and related marketing activity) in the bank. Things such as deposit accounts, underwriting, and data security are easily overlooked, but nonetheless are covered by UDAAP.
- *Incentivize Compliance and Ethical Conduct*. Affirmatively discourage troublesome conduct. Do not incentivize employees to make misleading statements. Scrutinize sales programs that reward extra charges.
- *Facilitate Informed Choices*. Focus customer attention on limitations, conditions, and other key terms. Make product and program documents readable and understandable.
- *Be Proactive, Not Reactive*. Seek out input from consumers and employees. Make it safe for employees to raise questions or concerns about products. Consolidate review of customer complaints so that discernable complaint trends are not ignored because the products technically comply with black-letter law. If public controversy starts to develop around a product or service, scrutinize it rather than reactively defending it. Conduct adequate due diligence on all new products and third-party service providers.
- *Keep Suitability Considerations Front-of-Mind*. If you do not, the regulators and courts might just do it for you.

Conclusion

The Bureau will open its doors in a matter of months and so, too, will the gateway to the Gulf of UDAAP. Institutions that are in the business of providing or servicing consumer financial products or services must mitigate the dangers of its abyss by making their best efforts to understand and maintain compliance with all UDAP/UDAAP laws, and otherwise remain informed of legal developments in this area.

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[1] *See* http://regreformtracker.aba.com/2011/01/dodd-frank-proposal-burden-exceeds-1000.html.

[2] *Id.*

[3] *Id.*

[4] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111-203, Title X, §§ 1031, 1036. A "covered person" is "any person that engages in offering or providing a consumer financial product or service" and "any affiliate of [such person] if such affiliate acts as a service provider to such person." Dodd-Frank Act, Title X, § 1002(6). A "service provider" is, generally speaking, "any person that provides a material service to a covered person in connection with the offering or provision of such covered person of a consumer financial product or service . . . ." *Id.* § 1002(26).

[5] *See* Dodd-Frank Act, Title X, § 1031(a), (b).

[6] Dodd-Frank Act, Title X, § 1031(c)(1).

[7] *Id.* § 1031(c)(2).

[8] *Id.* § 1031(d).

[9] 15 U.S.C. § 45(a).

[10] *See generally* Henry N. Butler & Joshua D. Wright, *Are State Consumer Protection Acts Really Little-FTC Acts?*, Florida Law Review 163 (2011).

[11] 15 U.S.C. § 57a(f).

[12] Letter from Julie L. Williams, Chief Counsel of OCC, *Guidance on Unfair or Deceptive Acts or Practices* (March 22, 2002).

[13] Letter from Michael J. Zamorski, Director of FDIC, *Guidance on Unfair or Deceptive Acts or Practices* (May 30, 2002).

[14] Statement of Fed and FDIC, *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (March 11, 2004).

[15] FTC Policy Statement on Unfairness (1980), available at http://www.ftc.gov/bcp/policystmt/ad-unfair.htm; FTC Policy Statement on Deception (1983), available at http://www.ftc.gov/bcp/policystmt/ad-decept.htm.

[16] *See generally*, Frank A. Hirsch, Jr, *The Evolution of a Suitability Standard in the Mortgage Lending Industry: The Subprime Meltdown Fuels the Fires of Change*, North Carolina Banking Institute Journal, 21 (2008).

[17] *Massachusetts v. Fremont Investments & Loan*, 897 N.E.2d 548 (Mass. 2008).

[18] Board of Governors of the Federal Reserve System, *Truth in Lending*, 73 Fed. Reg. 44522, 44523 (July 30, 2008).

[19] Board of Governors of the Federal Reserve System, Office of Thrift Supervision, and National Credit Union Administration, *Unfair or Deceptive Acts or Practices*, 74 Fed. Reg. 5498, 5500 (Jan. 29, 2009).

[20] Dodd-Frank Act, Title X, § 1021(b)(2).

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