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Regulatory: Unfair, deceptive, or abusive acts or practices – Part II

Symbiotic relationships among state and federal laws, regulators and plaintiffs' bar creates difficult compliance environment.

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This column is part of a series of articles on the new Consumer Financial Protection Bureau and the upcoming wave of regulations affecting the consumer financial industry.

As the consumer financial services industry adjusts to a variety of changes resulting from the Dodd-Frank Act, one area that is easily overlooked is Title X's provisions empowering the Consumer Financial Protection Bureau to prevent unfair, deceptive, or abusive acts or practices (UDAAP). UDAAP is not getting a lot of press coverage, and does not have the mass appeal of the political and power struggles brewing over who would be the bureau's first director and whether Congress will overhaul the new agency's funding mechanism. Nonetheless, UDAAP is a very real concern and one that must be taken seriously.

Any doubt about the appropriate level of concern for UDAAP should be resolved by a quick read through of the bureau's July 18, 2011 progress report, entitled "Building the CFPB." On page 4 of the report, laid out in a very large font, the bureau sets forth the three components of its vision for the consumer finance marketplace of the future. Listed as the second component of that vision is a market "in which no one can build a business model around unfair, deceptive, or abusive practices." Is UDAAP important to the bureau? You better believe it.

This particular vision is, of course, impossible to argue against. No one in their right mind is going to argue that the market for consumer financial products and services should be unfair, that businesses operating in this space should be able to conduct themselves in a deceptive manner or advocate for the sanctioned abuse of consumers. The devil, as we discussed in my last segment, is in the details of these amorphous concepts. What is unfair? What constitutes a deceptive or abusive practice? Let's dig a little deeper and see whether we should have any real concerns here.

The Federal Trade Commission Act (FTC Act), originally enacted almost a century ago, declared unlawful "[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce." This provision of the FTC Act is commonly referred to as "UDAP." UDAAP borrows from, but plainly expands on, UDAP. For example, UDAAP introduces a new concept to the statutory vernacular—abusive, and places plenary rulemaking and enforcement authority in the bureau. Prior to Dodd-Frank, the FTC enforced UDAP, except as against federally regulated financial institutions, which was in the province of prudential regulators. Within the next several months, the bureau and the FTC are required to reach an agreement for coordinating enforcement actions going forward. I suspect this will be an agreement dividing up turf as it relates to the consumer financial services industry.

Each of the 50 states also have enacted what are commonly referred to as "Little FTC Acts." These also constitute part of the body of law commonly referred to as UDAP. State UDAP statutes typically have broad applicability, and target consumer deception and abuse in the marketplace. Importantly, many of the Little FTC Acts allow for private rights of action, which critics of the FTC Act have long found to be a fundamental flaw in the federal UDAP law.

One thing that the Dodd-Frank Act will not change for the consumer financial services industry is the parallel development of UDAP law at the state level and UDAP/UDAAP federal level. Indeed, the

relationship between the federal regulators, on the one hand, and the state regulators and plaintiffs' bar, on the other, is symbiotic. Each monitors the other and law develops in both places on particular topics.

A good example of the apparently harmonious connection among all this law is found in the relationship between federal and state credit laws and UDAP. The Truth in Lending Act (TILA) requires certain disclosures in consumer credit transactions. Since the enactment of TILA, the FTC has found that violations of TILA and its implementing rules in Regulation Z are also unfair and deceptive acts or practice under the FTC Act. Certain states have issued similar regulations under their Little FTC Acts, and many courts have held that creditors who violate TILA likewise violate the applicable state UDAP provisions. So a single credit disclosure violation today could result in liability under TILA, the FTC Act, UDAAP and applicable Little FTC Acts? Yes, it could.

Why? Well, a short answer is turf protection. At the federal level, the FTC and the bureau each have turf. As noted, Dodd-Frank requires these two agencies to negotiate and settle any turf battles among them. State regulators have their turf. And, importantly, the plaintiffs' bar has its turf. With regard to this particular piece of real estate, the incentive to look toward UDAP is obvious. TILA permits a private litigant to recover actual damages and attorneys fees, but Little FTC Acts often allow for double or treble damages, a significant carrot at the end of a UDAP stick.

What should you expect? Common wisdom is that the bureau needs to start making an enforcement splash. One plausible forthcoming scenario is that the bureau will bring an enforcement action, or several actions, attempting to use UDAAP as the hammer. Win, lose, or draw (i.e., consented settlement), state regulators and plaintiffs' attorneys are likely to follow suit.

Another scenario is that the bureau will take UDAAP cues from state regulators and plaintiffs' attorneys. A recent hotbed of activity has been the "fairness" of so-called irresponsible and improvident lending. Courts around the country are divided over the issue of whether, for UDAP purposes, a lender has a duty to determine if a borrower can repay a loan. Will the bureau step out and make a definitive statement on this issue? This is more likely a question of when the bureau will act, not whether it will act.

Looking back, we can see that UDAP in the consumer financial services sector developed around activity at the federal, state, regulatory, enforcement, and civil levels. Expect the same under UDAAP. It is important to remember that we now have an industry dedicated regulator – the bureau – that is charged with preventing UDAAP. This is a much different environment than the pre-bureau environment where the FTC and prudential regulators were operating in this space.

In coming installments, we will dig deeper still to see what other dangers are lurking, and then look at some potential risk-mitigating solutions to avoid them.

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