

Why You Need To Pay Attention To UDAAP

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Title X of the Dodd-Frank Act gives the Consumer Financial Protection Bureau the power to take a variety of actions to prevent any entity underneath its regulatory umbrella from committing or engaging in an unfair, deceptive, or abusive act or practice (“UDAAP”) “under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service.”

Do you know that this is the law today? Is your company subject to this UDAAP prohibition? Is your institution in compliance with UDAAP? Have you taken steps to manage the risk presented by UDAAP? Do you understand UDAAP? Do you know why you should?

Who Is Subject To UDAAP?

Subject to some very limited exceptions, if your company offers, provides or services any consumer financial product or service, or is affiliated with any such entity, then it is subject to UDAAP. It is as simple as that. There is a relatively common — and dangerous — misconception that only banks are covered by Title X’s prohibition against UDAAP.

While it is true that banks and similar institutions are subject to a level of federal regulatory supervision and oversight that most other entities engaged in the consumer financial services area are not, that is going to change in some meaningful ways.

Over time, the Consumer Financial Protection Bureau is expected to expand its own supervision jurisdiction to “larger participants” in the market. This means that nonbanks — like loan servicers and credit reporting agencies — may soon be subject to bank-like examinations. Regardless of whether the bureau supervises your institution, however, UDAAP applies, and the bureau has the power to enforce it.

Why You Should Understand UDAAP

You should understand UDAAP because it is a priority policy initiative for the bureau. This past July, the bureau announced its three-part vision for a consumer finance market place as one:

- where customers can see prices and risks up front and where they can easily make product comparisons;
- in which no one can build a business model around unfair, deceptive or abusive practices;
- that works for American consumers, responsible providers and the economy as a whole.

Thus, a full one-third of the bureau’s vision is dedicated to UDAAP. With a powerful, well-funded and popular new federal regulator focused on UDAAP, you should be too. Keep in mind that the bureau refers to itself as the badge-carrying cop on the consumer financial services “beat.” Stated differently, the bureau is out there looking for problems, and, if it chooses, it has the money and the madate to look, and look, and look.

Understanding UDAAP

You should also understand UDAAP because it is one of the bureau’s most potent tools. The UDAAP standards — unfairness, deception and abuse — are vague, amorphous, broad and infinitely flexible. Any determined regulator worth her weight in statutes and regulations can squeeze pretty much any consumer financial product or service into one of these concepts, at least at a superficial level.

So what do these standards mean under the Dodd-Frank Act?

Title X defines two of the terms. “Unfairness” is an act or practice 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.”

An “abusive” act or practice:

(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.

Curiously, the Dodd-Frank Act does not define "deceptive," notwithstanding the decades of precedent illuminating the concept that Congress presumably had at its fingertips at the time it was drafting Title X.

The Bureau’s View of UDAAP

On Oct. 13, 2011, the bureau released Supervision and Examination Manual — Version 1.0 (“Version 1.0”). In one sense, Version 1.0 is helpful because it confirms that the bureau is going to rely, at least in part, on the historical development of the definitions of unfair and deceptive by stalwart federal regulators like the Federal Trade Commission, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. In fact, the bureau gives real-life examples of deceptive and unfair acts or practices, all of which were developed under the auspices of one of these regulators.

What about abusive? Good question. The bureau says precious little about what it thinks are abusive acts or practices. Version 1.0 states only the following: “Although abusive acts also may be unfair or deceptive, ... the legal standards for abusive, unfair, and deceptive each are separate.” I am quite certain I have never before read something so monumentally unhelpful.

At one level, and as demonstrated by Version 1.0, UDAAP is an extension on the Federal Trade Commission Act’s prohibition on unfair or deceptive acts or practices (“UDAP”); the extra “A” in UDAAP is just the addition of the term “abusive” — which, by the way, is oft referred to as the most feared word in all of Dodd-Frank.

At another level, UDAAP is significantly different from UDAP. While both the FTC and the bureau have the responsibility under UDAAP/UDAP, respectively, to act as the investigator, prosecutor, judge and even the rule maker, the bureau has an important and powerful additional responsibility — that of examiner. Thus, the bureau gets to review the confidential data, documents, activities and other information of the entities it supervises. For many currently unregulated financial services companies, this will be a first. If it sounds a little like putting the fox in the hen house, that is because it is pretty much like putting the fox in the hen house.

Another significant divergence between UDAAP and UDAP is the difference in leadership at, and the funding of, the bureau versus the FTC. The FTC is headed by five commissioners nominated by the president and confirmed by the Senate. The bureau will ultimately be headed by a single director who will be nominated by the president and confirmed by the Senate. Former Ohio Attorney General Richard Cordray is currently in the queue for the job, but that nomination is being held up in the Senate.

In terms of funding, the bureau gets its money outside of the traditional federal budget appropriations process. Instead, the bureau's entire budget is set as a percentage of the Federal Reserve Budget, effectively insulating the bureau from outside political pressure and influence. These two features — leadership and funding — give the bureau some very real and unchecked powers.

What Can the Bureau Do and Against Whom?

Well, if you offer or provide a consumer financial product or service, or are affiliated with any such entity, then the bureau has the power to stop you from engaging in UDAAP. How can it do that?

The bureau has very significant statutory enforcement powers. By way of example, the bureau can launch an investigation, engage in administrative discovery, conduct hearings and commence civil litigation to impose a civil penalty. The civil penalties can be quite stiff.

A run-of-the-mill UDAAP violation — if there is such a thing — can draw a penalty of up to \$5,000 per day. Reckless violations will cost you \$25,000 per day and knowing violations will cost you up to \$1 million per day. In appropriate UDAAP cases, the bureau can seek as relief, among other things, rescission or reformation of agreements, refunds, restitution, disgorgement of profits and the payment of government incurred costs.

What Can You Do?

There is a lot that you can do and should be doing. First, if these concepts are new to you and your organization, you need to — you must — get up to speed on them as soon as possible. Talk to folks who are familiar with the concepts so that you can identify potential problem areas. You can minimize your UDAAP exposure by taking extra care in some of the more high-profile problem areas (e.g., products or services targeting certain vulnerable groups or that raise suitability concerns).

Second, think about an audit and compliance review of your practices, policies, products and services. This is both an investment in the stability of your business and various product lines, as well as a great way to significantly reduce the risk of a UDAAP violation. And if you outsource the audit, get your vendor to put "skin in the game." By doing this, your vendor is more likely to focus, and your institution will get some much needed security in an area that is otherwise full of uncertainty.

Finally, be proactive! The bureau is not going to tolerate you waiting for it to identify your UDAAP problems. The new world order is one in which consumer financial services companies must identify UDAAP issues before they become problems. There are simple ways to accomplish this.

By way of example, do not just sit and wait for the complaints to pile up. Rather, analyze them when they come in the door. Facilitate informed choices by your customers. Bring your compliance and legal functions into the room while products are being developed instead of waiting to the end of the development cycle. Incentivize compliance and the ethical conduct of everyone in the organization. These straightforward solutions will go a long way to avoiding trouble down the road.

UDAAP, the statute, is here and live now. The bureau's vision is to eliminate UDAAP from the market. If you are not helping the bureau accomplish that vision, the new "cop on the beat" may just use its enforcement powers to coerce you into doing so.

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