Know before you loan: Shouldn't the Consumer Financial Protection Bureau provide clarity regarding UDAAP?

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Some of the most popular efforts of the barely one-year old Consumer Financial Protection Bureau ("Bureau") have been the "Know Before You Owe" programs developed for credit cards, mortgages, and student loans – three consumer credit products long associated with complex and complicated documentation. The Bureau designed these consumer-focused programs with the stated goals of providing simpler, clearer, and more transparent forms and credit information. While these programs are far from the only consumer-focused efforts the neo-federal agency has worked on, they do provide a stark backdrop for the void of analogous help the Bureau has provided for some of the more challenging issues facing the consumer financial services industry in the wake of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act ("Dodd-Frank Act"). Notwithstanding the industry's call for more clarity about the Dodd-Frank Act's prohibition against the nebulous "unfair, deceptive, or abusive acts or practices," the Bureau has done little to respond. If consumers can have the benefit of the "Know Before You Owe" programs, why can't the industry get similar consideration with a "Know Before You Loan" program?

When Richard Cordray, the Bureau's Director, recently delivered his first semiannual report to the House Financial Services Committee, several committee members pressed him on the definition of "abusive" financial practices. Just as Supreme Court Justice Potter Stewart famously wrote about pornography, "I know it when I see it," Cordray told the committee "most good businesses know an abusive practice when they see it."

While the "we'll know it when we see it" approach may (stress *may*) work with pornography, it is not so easy to identify UDAAP violations because the Dodd-Frank Act provided little, if any, guidance on each of the standards, and the Bureau has yet to provide any meaningful guidance on how it views UDAAP. The lack of regulatory direction on UDAAP is underscored by the Bureau's recent $210 settlement of an enforcement action involving allegedly deceptive marketing of credit card "add ons" like payment protection and credit monitoring. This particular development underscores the urgent need for guidance and begs the question: why won't the Bureau provide more transparency on UDAAP before it engages in significant enforcement actions?

Abusive, for instance, is a relatively new concept in the financial services industry with no generally accepted definition. And while "unfair" and "deceptive" have been defined in other statutes, most significantly in Section 5 of the Federal Trade Commission Act (the "FTC Act"), one could argue that the Bureau has no obligation to adopt the FTC's pronouncements on or the case law interpreting those terms under the FTC Act. Without any guiding rules to play by, UDAAP is in the eye of the beholder (*i.e.*, the Bureau). This amorphous and uncertain environment leaves banks and other consumer financial services companies – and their compliance officers – with little to go by but their training and intuition. This untenable situation can and should change.

The Bureau has the ability, through its rulemaking power, to provide shape to UDAAP and give the financial community direction about what practices and services will not pass muster under the Dodd-Frank Act. The Bureau, after all, exercised this power on numerous other occasions over this past year, why not as to UDAAP? Without some sort of further guidance from the Bureau – rulemaking, a formal

policy statement, etc. – the innovation of beneficial consumer products and services, and the much-needed healthy growth of consumer credit in the United States may be stymied.

Given the Bureau's significant enforcement powers – including the ability to investigate, conduct hearings, and adjudications, litigate and seek various remedies, including civil penalties of up to $1,000,000 per day – to prevent UDAAP in connection with any transaction or offering of a consumer financial product or service, it is imperative that the Bureau become transparent about what it believes constitutes UDAAP.

A CONCERTED CALL TO ACTION

Hoping to avoid the vagaries of the UDAAP standards under the Dodd-Frank Act, the consumer financial services community has been vocal in encouraging the Bureau to define the UDAAP standards through its rulemaking power. Much of that attention has been focused on the vague "abusive" standard. Recently, for instance, David Hirschmann, the president and chief executive of the United States Chamber of Commerce's Center for Capital Markets Competitiveness, specifically said the Bureau should outline what constitutes potentially "abusive" acts or practices under Dodd-Frank. While the Bureau has said that legitimate businesses have nothing to fear, "provided they play by the rules," Hirschmann argued that "in many cases, those rules remain ambiguous because terms are undefined, and the regulatory and supervisory processes are overlapping and inconsistent." Hirschman added that the creation of the Bureau, "with its broad responsibility for overseeing supervision, regulation, and enforcement of existing consumer financial protection laws, and the implementation of new federal standards, has made it more, rather than less difficult for companies to know what is expected of them."

Similarly, Richard Riese, senior vice president for the American Bankers Association's Center for Regulatory Compliance, noted that "[r]ight now we're not seeking any real regulatory activity involving the new 'abusive' area. It's one which bankers would rather have some upfront, explicit guidance about where future application might occur, rather than see it cited out of the blue in a gotcha approach during an exam."

WHAT WE DO KNOW ABOUT THE UDAAP STANDARDS

As noted above, the Dodd-Frank Act prohibits any provider of consumer financial products or services or a service provider to engage in any "unfair," "deceptive," or "abusive" act or practice.

An "unfair" practice under UDAAP is one that: (1) it causes or is likely to cause substantial injury; (2) that cannot be reasonably avoided; and (3) the injury is not outweighed by any benefits. While the "unfair" and "deceptive" standards have been given concrete meaning in other consumer protection acts, such as the FTC Act, the Bureau can adopt or abandon such non-binding precedent. In fact, the Bureau, while a helpful step in the right direction, has included the FTC Act definitions in its Examination Handbook, but these definitions are not binding on the Bureau, could be changed at any time, and fall far short of illuminating the terms.

The new "abusive' standard is perhaps the most tricky of the three UDAAP standards. The Dodd-Frank Act defines 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.

The Bureau has been clear that "abusive" is a separate standard from the more familiar "unfair" and "deceptive" standards. Cordray, for example, has stated – and the Bureau's Examination Manual reflects

– that "there is a distinction among each of these categories" and "that isn't to say there can't be some overlap." He noted "there could be a practice that would not be unfair but that would be abusive." The Bureau, however, has not clearly defined the meaningful differences between the three standards making Cordray's pronouncement all but meaningless.

THE BUREAU CAN – AND SHOULD – CLEAN THINGS UP

The Bureau appears intent on utilizing its enforcement powers to define the UDAAP standards, rather than engaging in rulemaking or other efforts that would set forth, in advance, what financial institutions have to do to avoid running afoul of this aspect of the Dodd-Frank Act. In his remarks this past March to the oversight committee, Cordray stressed that Congress defined abusive, not the Bureau. He noted that his "job as director is to enforce the law Congress enacted." He further stated "how the law that Congress has defined applies in particular situations is something that we're going to have to measure on a facts and circumstances basis as we go . . . . it's our job to try to apply it . . . . We could perhaps clarify how it applies in particular facts and circumstances, but I think we ought to take some time with it. . . ." Again, wildly unhelpful. But the Director did not stop there.

Cordray further pointedly stated that he didn't "anticipate [the Bureau] writing a rule around UDAAP" stating that "I think a lot of the law is really clear in that area, and what is maybe not clear to people because they haven't had experience with it has been specifically defined by congress, so that is what it is. We'll continue to develop as we go." But by relying solely on the enforcement of individual cases, is the Bureau considering the likelihood of harm to the industry and consumers for its failure to provide some clarity here?

With respect to the "abusive" standard, the Chamber of Commerce's Hirschmann told the Bureau last year that "[i]t is the bureau's responsibility to ensure the law is enforced consistently and disparate standards do not impose excessive compliance burdens and fragment our national credit market at a time when it is already under serious strain. A policy statement defining the term [abusive] will help prevent divergent interpretations of the 'abusive' standard." This sounds profoundly reasonable. It is precisely what the FTC did under not dissimilar circumstances.

If not a policy statement, then the Bureau should engage in rulemaking under the Administrative Procedures Act to establish upfront whether a particular act or practice is unfair, deceptive, or abusive. The Bureau has the authority to prescribe rules and to issue guidance "as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof." 12 U.S.C. 5512(b)(1). The Bureau, under this authority, "may prescribe rules applicable to a covered person or service provider identifying as unlawful any unfair, deceptive, or abusive acts or practices 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." 12 U.S.C. 5531(b). In prescribing rules under Section 1031, the Bureau must consult with the Federal banking agencies, or other Federal agencies as appropriate, concerning the consistency of the proposed rule with prudential, market, or systemic objectives administered by such agencies. While this may sound daunting, the Bureau has effortlessly engaged in rulemaking numerous times over its brief lifespan.

Unfortunately, basic administrative law principles do not set forth any guidelines for an agency to utilize in deciding whether to pursue rulemaking over adjudication. In fact, the Supreme Court has held that the choice between the two "lies primarily in the informed discretion of the administrative agency." There are, however, advantages to rulemaking that make it a superior choice for the Bureau in this context, however.

First and foremost, rulemaking would provide clear a articulation of the Bureau's view on the UDAAP standards, which would have a ripple effect of benefits on consumers, the Bureau, and financial institutions. For example, rules would:

• **Save Resources.** Rulemaking can narrow the issues that would be subject to examination by the Bureau. Overtime, this would decrease the amount of effort and perhaps even litigation caused by the uncertainty. In turn, there should be a universal savings achieved by the Bureau, consumers, and the consumer financial services industry. Additionally, a set of clear rules around the UDAAP standards would allow financial institutions to develop more accurate and efficient compliance mechanisms, instead of spending resources trying to guess what practices and services are banned by UDAAP under the Dodd-Frank Act.

• **Provide Clarity.** Rulemaking provides greater clarity and greater uniformity in application than informal policy, or policy made through supervision, enforcement, and adjudication. Clear, fair, published rules provide everyone with a roadmap of their legal duties.

• **Provide Uniformity And Consistency.** Rules are (relatively) uniform in application, whereas adjudications are dependent on a number of variables, from the particular fact finder to the particular facts of a particular case. Published rules will allow the Bureau to articulate its policy about the UDAAP standards without regard to particular facts. Relying on supervision, enforcement, and adjudication alone would allow the Bureau to articulate its view on the UDAAP standards on a case-by-case basis, bit by bit as particular facts present themselves, instead of at one time through rulemaking. This is wildly unfair to the all participants in the industry (*e.g.*, consumers, banks, financial institutions, service providers, etc.). Additionally, different examiners may have different views on how to apply the UDAAP standards, which would result in various interpretations, adding to the confusion about what acts and practices are banned under Dodd-Frank. While the Bureau does not allow field determinations regarding UDAAP, there is nothing preventing that from changing in the future.

• **Provide For Stakeholder Input.** Rulemaking would allow the interested public to comment on how the Bureau proposed to interpret UDAAP and to give them opportunity to be heard on the proposals. Rulemaking would allow policy considerations to be incorporated, rather than piecemeal ad-hoc adjudications. The Bureau would be more informed about issues affecting the UDAAP standards and a better rule is likely to result.

WHAT SHOULD THE RULES SAY?

With respect to "unfair" and "deceptive" acts or practices, the Bureau could easily start with the course followed by the FTC and others in interpreting these standards. From there, the Bureau should be as transparent as is practicable in letting lenders know precisely what it believes are unfair or deceptive acts or practices. Let them know before they loan. Defining "abusive" acts or practices will require a little more effort.

The Chamber of Commerce has asked that the Bureau set forth a policy statement defining the term, in a similar fashion to the FTC's 1980 policy statement issued by the FTC defining the Commission's consumer "unfairness" authority. The Chamber of Commerce argued that this "will help to prevent divergent interpretations of the 'abusive' standard around the country, and provide much needed clarity to legitimate businesses trying their best to ensure that their actions comply with the law." The FTC's policy statement gave stakeholders "a concrete indication of the manner in which the Commission has enforced, and will continue to enforce, its unfairness mandate . . . to provide a greater sense of certainty about what the Commission would regard as an unfair act or practice under Section 5." The policy statement delineated the "Commission's views of the boundaries of its consumer unfairness jurisdiction." This is one take – and perhaps a good starting point of the discussion – for the type of guidance needed with respect to the Dodd-Frank Act's "abusive" standard.

Another useful action the Bureau could take would be guidance applicable to specific categories of consumer practices regarding acts or practices that it will not consider to be UDAAP violations, or ones that will be considered violations, but only under certain specific circumstances. The Bureau could also provide guidance about how a bank could ensure that consumers understand the risks and costs of

products, and whether a particular product meets the consumer's needs. Guidance of this sort would provide the roadmap financial institutions need to proceed without fear of action against them by the Bureau.

WITHOUT AN UPFRONT SET OF RULES, FINANCIAL INSTITUTIONS WILL INNOVATE LESS AND WILL PASS INCREASED COMPLIANCE COSTS ON TO CONSUMERS

In the absence of clear rules on what are "unfair," "deceptive," or "abusive" acts or practices, financial institutions could be forced to increase the costs of financial products because they will have to pass along the increased costs of ensuring that each individual customer is educated about the risks and limitations of products. Additionally, financial institutions may shy away from introducing new products without some upfront assurance that they are not running afoul of the Bureau, thereby narrowing the range of consumer choice. The Bureau possess the power to avoid this uncertainty and allow the financial sector to innovate and provide new products with the knowledge necessary to meet Dodd-Frank's goals and standards. Let them know before they loan.