UDAAP
Understanding What It Is and Where It Applies

Presented by:
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This session provides an overview of various aspects of the check payments systems including legal and rules framework for check image exchange. Responsibility for compliance with image exchange rules and/or legal, operational and regulatory requirements applicable to check image exchange remains at all times with the financial institution participants and/or the individual or company using a check image exchange service.

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Financial institutions should consult with their legal counsel regarding legal and operational requirements applicable to any check image exchange program they may offer or in which they participate.
Overview of Today’s Presentation

- Will focus on UDAAP in context of banking and financial services
- Why so much interest in UDAAP today?
- Background and legal basis for UDAAP
- Review each statutory element of UDAAP
- CFPB guidance and enforcement of UDAAP
  - Focus on deposit and payment products
- CFPB expectations on internal controls to prevent UDAAP violations
- New Banking Agency Guidance on Deposit Reconciliation – UDAAP Connection
What is “UDAAP”?

- It is an acronym for: “Unfair, Deceptive, and Abusive Acts and Practices”
- These practices are prohibited by federal banking law
- Each term is a separate statutory prohibition on these acts and practices
- A particular business practice could violate one, two or all three of these prohibitions
- Banks are prohibited under federal law from engaging in acts and practices that meet one of these standards
- There are currently no statutory or regulatory listing of specific practices that constitute a UDAAP violation
Why is UDAAP a hot topic in consumer banking and financial services?

- CFPB has used new UDAAP authority to prohibit range of financial practices
  - Practices that were not addressed in other laws
  - Some practices that had been ongoing for number of years/multiple institutions

- CFPB’s UDAAP authority not limited to prohibiting practices that are prohibited under other laws or regulations
  - Can use UDAAP to informally define new standards of practice for financial institutions
CFPB has been busy in enforcement area

As of mid-year 2015:

- $10.1 billion in payments or restitution or other relief to consumers from CFPB enforcement activity
- $248 million in monetary relief provided to consumers as a result of CFPB supervisory actions
- $286 million paid in civil penalties by financial institutions as a result of CFPB enforcement activity
- Many of these enforcement actions involved UDAAP claims alone or in combination with other consumer protection law violations
Before the enactment of the Dodd Frank Act:

- Prohibition on “UDAP” under Federal Trade Commission Act
- FTC empowered to prevent persons from using “unfair or deceptive acts or practices” in or affecting commerce. 15 U.S.C. § 45(a)(2)
- Bank Agencies could enforce this UDAP prohibition against banks and other depository institutions
In 2010, Congress expanded “UDAP” standard in the Dodd–Frank Act:

- Dodd Frank Act added the “abusive” acts or practices to the prohibited activities under UDAAP
- Transferred “UDAAP” authority to new federal agency
  - Consumer Financial Protection Bureau
  - CFPB has authority over range of financial institutions and financial products
  - Reaction to financial crisis
- CFPB may take any action to prevent a financial institution from:
  - Engaging in an “unfair, deceptive, or abusive act or practice”
  - 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.
- CFPB authorized to enforce UDAAP against banks and other financial institutions
- CFPB also has authority over service providers to financial institutions
Who has Rulemaking Authority For UDAAP?

- CFPB has primary rulemaking authority
  - Has rulemaking authority to identify unlawful unfair, deceptive, or abusive acts or practices in connection with consumer financial products or services
  - CFPB has not issued a formal regulation defining practices that may constitute UDAAP violations
  - CFPB has issued informal guidance on how it will apply UDAAP:
    - Examination Guidance for its Examiners
    - CFPB Bulletins to Financial Institutions
    - Also will look to certain FTC guidance regarding “UDAP”
    - Informal CFPB guidance is not necessarily binding precedent – outcomes can vary in different situations
  - Past enforcement orders also show:
    - Business practices that are a concern to CFPB
    - What may constitute UDAAP violations in other cases
What are “Unfair” Acts or Practices?

- Statutory Standard
  - Dodd–Frank Act defines a business practice as “Unfair” when:
    - Practice causes or is likely to cause substantial injury to consumers
      - Typically monetary harm – such as service fees paid by consumer
      - Risk of harm or actual harm
    - The injury is not reasonably avoidable by consumers
      - Example: Bank’s practice interferes with consumer’s ability to effectively make decisions
    - The injury is not outweighed by countervailing benefits to consumers or to competition
      - Is injury to the consumer offset by any competitive or consumer benefits produced by the same act
Examples of “Unfair” Acts

- Processing Remotely Created Checks (RCCs) for telemarketer without appropriate policies to detect fraud
  - BOFD Bank had large volume of RCC deposits
  - High return rates on RCCs
  - Bank did not investigate reason for return rates or take steps to reduce or control return rates
  - CFPB found substantial injury to consumers
    - Consumers lost funds from fraudulent checks posted to accounts
    - *Enforcement Order: In Wachovia Bank Consent Order with OCC (April 2008)*

- Dishonoring credit card convenience checks without notice
  - Substantial injury to consumers:
    - Paid returned-check fees
    - Negative impact on credit history
  - Injury not reasonably avoidable:
    - Consumers reasonably relied on expiration dates on the checks
    - *Enforcement Order: In Re American Express Bank (2009)*
Examples of “Unfair” Acts (con’t)

- Processing Payments in Manner other than Customer’s Selection
  - Customer authorized PayPal to process payment as credit or debit card payment
  - Instead, PayPal processed payment as “Bill me Later” credit-line payment

- Creation of RCC after Customer Cancels ACH Authorization
  - Payday lender’s loan contract allowed lender to create RCC if ACH debit authorization was canceled
  - Lender used RCC to take funds customer did not owe
  - Lender’s use of RCC caused harm as it prevented consumer from exercising stop payment rights
    - *CFPB v. Integrity Advance (2016)*
What are “Deceptive” Acts or Practices?

- **Statutory Standard**
  - Dodd–Frank Act does not define “deceptive” practices
    - Look to CFPB guidance
    - Also look to FTC guidance and enforcement orders
  - A bank’s representation/practice is deceptive when:
    - It misleads or is likely to mislead the consumer;
    - The consumer’s interpretation of bank’s representation/practice is reasonable under the circumstances; and
    - The representation/practice is material. *(See FTC Policy Statement on Deception; CFPB Examination Manual – UDAAP)*
What are “Deceptive” Acts or Practices? (Con’t)

- Elements of Deceptive Acts or Practices
  - *Likely to Mislead*: consider statement in context of entire advertisement, transaction, or course of dealing
  - *Consumer Interpretation*: reasonableness of consumer’s interpretation is considered from consumer perspective (not business)
  - *Materiality*: Is the representation/practice likely to affect a consumer’s choice regarding the service?
    - Costs and benefits of service are material factors in consumer choice
    - Certain categories of information are presumed to be material
      - Pricing of services
      - Benefits and limitations of services
What are “Deceptive” Acts or Practices? (Con’t)

- **Example of Deceptive Act or Practices**
  - **Misrepresentation about FDIC Insurance for Payment Product**
    - Credit union and its service provider incorrectly stated in marketing and account materials that a secured credit card deposit was “FDIC insured”
    - No actual financial loss was caused due to lack of insurance
  - **Misrepresentation regarding Purpose of Customer Call**
    - Bank called customer and stated purpose of call was a “courtesy call”
    - Purpose of call was actually to market bank’s products
      - *In Matter of Discover Bank (2012)*
  - **Misrepresentation about Product Terms**
    - Bank and its service provider represented in sales call that identity theft protection would protect consumer from losses from identity breach
    - Sales call did not disclose material limitations on protection coverage
      - *CFPB v. Affinion Holdings (2015)*
What are “Abusive” Acts or Practices?

- **Statutory Standard**
  - Dodd-Frank Act defines an “abusive” act or practice:
    - Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
    - Takes unreasonable advantage of:
      - Consumer’s lack of understanding of the material risks, costs, or conditions of the product;
      - Consumer’s inability to protect the interests in selecting or using a consumer financial product; or
      - Consumer’s reasonable reliance on bank to act in the interests of the consumer.
What are “Abusive” Acts or Practices? (Con’t)

- **Example of an Abusive Act:**
  - Threatening an action that bank does not have the authorization to pursue
    - Ex. Debt collector falsely threatened prosecution for non-payment of a debt
      - *CFPB Bulletin 2013–07*
  - Lack of Customer Service to Resolve Complaints Regarding Payment
    - PayPal processed credit payments instead of customer selected payment type
    - Customers then could not reach PayPal customer service to address PayPal errors
    - PayPal customer service also ignored or did not resolve customer complaints
    - Customers could not protect themselves from PayPal customer service action or PayPal payment processing error
How do CFPB and the Banking Agencies identify potential UDAAP violations?

- Examination of financial institution’s products and services
- Requests for information from financial institutions
- CFPB’s Consumer complaint database
- Whistle blower information
- Other Sources
CFPB Enforcement Authority to Correct UDAAP Violations

- Civil Investigative Demands and Subpoena Authority
- Hearings
- Cease-and-Desist Proceedings
- Litigation Authority
- Monetary Penalties
  - $5,000 per day for a violation of a law, rule or final order or condition imposed by the CFPB
  - $25,000 per day for recklessly engaging in a violation of a federal consumer financial law
  - $1,000,000 per day for knowing violations of a federal consumer financial law
Discover Bank Enforcement Order -- Telemarketing Practices

- **Background:**
  - Discover Bank used telemarketing to sell credit loss protection and identity theft protection to cardholders.
  - Telemarketers:
    - used misleading language
    - downplayed key product
    - spoke inaudibly when discussing price and terms

- **The CFPB and FDIC found that consumers were:**
  - Misled about the fact that there was a charge for the products;
  - Enrolled without their consent;
  - Had material information about product withheld from them.

- **Under CFPB enforcement action Discover:**
  - Stopped deceptive marketing
  - Paid restitution to 3.5 million consumers in the amount of $200 million
  - Paid a $14 million penalty to CFPB
Review of Selected CFPB Enforcement Actions (Con’t)

- **Regions Bank Enforcement – Overdraft Policies**
  - **Background:**
    - Bank offered overdraft services with its checking accounts.
    - Overdraft can occur when consumers spend more money from their checking accounts than is available.
    - Bank covers the overdraft payment by advancing funds on the consumer’s behalf.
    - Federal rules prohibit banks from charging overdraft fees on debit card transactions unless consumers affirmatively opted in.
  - **CFPB alleged the following UDAAP violations:**
    - Bank failed to obtain required opt-ins for certain consumers;
    - Bank delayed fixing the violation until almost a year after discovering it; and
    - Bank misrepresented overdraft and non-sufficient funds fees related to its deposit advance product.
  - **CFPB Enforcement action:**
    - Provide refund to 200,000 affected consumers in the amount of $35 million
    - Correct errors on credit reports
    - Pay a $7.5 million fine.
Review of Selected CFPB Enforcement Actions (Con’t)

- Citizens Bank Enforcement Order – Customer Deposit Adjustments
  - Multiple enforcement orders of OCC, FDIC and CFPB – August 10, 2015
  - Agencies alleged:
    - Bank engaged in unfair and deceptive practice with respect to its handling of deposit slip “discrepancies”
      - Discrepancies caused by customer error or bank error in encoding/reading slip
    - Bank did not investigate the error if the discrepancies fell below a certain dollar amount
      - Bank credited customer with the dollar amount encoded on deposit slip
      - Certain customers did not receive the full amount of actual deposit
    - Bank’s account agreement did not describe the Bank’s actual deposit crediting practices
  - Agencies alleged that the Bank engaged in an “unfair, deceptive or abusive practice”
    - Practice caused substantial injury to consumers – loss of funds from incorrect credit amount
    - Bank materials misstated deposit crediting practices
  - Bank agreed to:
    - Imposed civil money penalties totaling $20.5 million
    - Bank to pay restitution to customers of at least $11 million
What sort of internal controls does CFPB expect a bank to have to protect against UDAAP violations?

- Written policies to ensure financial products comply with UDAAP
  - Part of larger compliance management program
- Review of new financial products
- Review of product materials to ensure not misleading/deceptive
- A system of periodic quality assurance around financial products
- Independent audits/reviews of financial products
- Oversight of affiliates and third party service providers used to provide financial products
- A system for handling consumer complaints
- Comprehensive training program for bank employees on UDAAP and compliance issues

*Sources: CFPB Examination Manual; CFPB Bulletin on UDAAP – July 2012*
In May 2016, CFPB and Bank Agencies issued new supervisory guidance:
- Addresses bank’s account deposit reconciliation practices
- Guidance expresses Agencies’ UDAAP authority/expectations
- Supervisory guidance, not rulemaking

Applies to banks’ receipt and reconciliation of deposits from customers
- Not limited to just consumer customers
- Applies to all forms of deposit – cash, check, image, electronic payments
- No detailed examples regarding level of bank investigation in reconciliation
  - Provides one example of when reconciliation not possible
  - Item is damaged to the point that its true amount cannot be determined
UDAAP and New Supervisory Guidance on Deposit Reconciliation Practices Con’t

Agency Statement of Applicable Federal Laws
- Laws relevant to deposit reconciliation practices:
  - Expedited Funds Availability Act, as implemented by Regulation CC
  - Section 5 of the Federal Trade Commission Act
  - Dodd-Frank Act – UDAAP Prohibition

Agency Supervisory Expectations For Bank’s Deposit Reconciliation
- Bank should adopt deposit reconciliation policies and practices that are:
  - Designed to avoid discrepancies in first place
  - Designed to reconcile or to resolve discrepancies so that customers “are not disadvantaged”
- Bank should implement compliance program for deposit reconciliation:
  - Policies and procedures
  - Internal controls
  - Training and oversight
  - Review processes for compliance with applicable laws/customer fairness.
- Information provided to customers about deposit reconciliation practices should be accurate
Questions?

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Wrap Up

Recording of today’s session
– Available on ECCHO Education page at: www.eccho.org/education#ECCHOInsights

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– 1.8 NCP CE credits
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Thank You

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