

UDAAP controls for managing risk

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ABSTRACT

Compliance with unfair, deceptive or abusive acts or practices (UDAAP) principles is a complicated matter for most financial institutions (FIs), large or small. In the USA, UDAAP regulations are broadly defined and fairly subjective in interpretation, especially when applied by regulators with the benefit of hindsight. An allegation of 'unfair', 'deceptive' or 'abusive' can arise in any aspect of the FI's retail footprint, from the initial development and marketing of products and services, through to management of complaints and servicing. The increased complexity of financial products and services, along with a myriad of communication and delivery methods, has made the compliance task more daunting in terms of preventing UDAAPs from occurring. This paper is intended to help identify



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potential UDAAP risks and provide practical guidance for mitigating those risks with strong controls as part of a comprehensive compliance management system (CMS).

Keywords: UDAP, UDAAP, unfair, abusive, deceptive (practices), compliance management system (CMS), risk assessment

GLOBAL PERSPECTIVE

The concept of ‘fairness’ for consumers is embedded in financial laws and regulations around the world. In the UK, the Financial Conduct Authority’s *Treating Customers Fairly* initiative underscores the importance for financial firms to demonstrate that fair treatment of customers is consistently at the heart of their business model.¹ In Singapore, the Monetary Authority of Singapore’s *Fair Dealing Guidelines* establishes expectations for financial institutions as a central concept in corporate culture to offer products and services that are suitable for the target audience along with clear, relevant and timely information.²

US RETROSPECTIVE

The concept of ‘fairness’ has been a part of the US regulatory framework for over 100 years. Originally a standard to protect consumers from unfair competition, the Federal Trade Commission Act (FTC Act) was promulgated in 1914.³ It was the Wheeler-Lea Act, passed in 1938, that first coined the phrase ‘unfair or deceptive acts or practices’, commonly referred to as ‘UDAP’ as part of the FTC’s Act Section 5.⁴ Neither ‘unfair’ nor ‘deceptive’ were defined in the statute, and the FTC had authority to impose civil money penalties (CMPs) for violations of Section 5 standards.

Most of the FTC’s early enforcement activity was limited to sales and marketing practices, primarily relating to advertising.⁵ (In fact, this emphasis has continued through today, as the FTC website remains a source

of advertisement and marketing guidance, as well as a source of information relating to the various federal consumer protection laws that prevent fraud, deception and unfair business practices enforced by the FTC.⁶)

The regulation of FIs was expressly carved out of the FTC Act from the very beginning.⁷ In 1975, the Magnuson-Moss Warranty Act authorised the prudential banking regulatory agencies to enforce UDAP, and establish an office of consumer affairs for receiving complaints for FIs within their jurisdictions. This applied to the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Association (NCUA).⁸ The FRB was also given rule-writing authority, although other agencies were empowered to write their own procedures to support enforcement.⁹

In 1985, the Federal Reserve Board published Regulation AA — *Unfair or Deceptive Acts or Practices*, which codified FTC Act Section 5 UDAP rules into federal banking regulations.¹⁰ Regulation AA also prohibited onerous consumer credit contract terms, required certain notices to co-signers and made the practice of pyramiding late charges illegal.¹¹ Thereafter, the FDIC and OCC issued guidance documents to describe the types of activity that posed UDAP risks.¹²

The Consumer Financial Protection Bureau (CFPB) was created in 2010 as part of Title X of the Dodd-Frank Act (DFA). It was designed to curb many of the acts or practices that were believed to have precipitated the events that led to the financial crisis of 2007–2008.¹³

As part of the Dodd-Frank Act, the prohibition against unfair or deceptive acts or practices (UDAP) was expanded to include a prohibition against ‘abusive’ acts or practices, which added the second ‘A’ to UDAP to create ‘UDAAP’.¹⁴ The DFA also assigned rulemaking authority for UDAAP to the CFPB.¹⁵ Thereafter, the FRB repealed

Regulation AA in accordance with the repeal of the FRB's authority to write rules addressing unfair or deceptive acts or practices.¹⁶

During 2018, there were some changes at the CFPB, which is now known as the Bureau of Consumer Financial Protection (BCFP or 'Bureau'). Under Acting Director Mick Mulvaney, there is an expectation that the BCFP may exercise more restraint in the 'regulation by enforcement' approach of the CFPB, which resulted in an expansive interpretation and very high-dollar fines for UDAAP violations. Rather, enforcement for UDAAP will continue within the boundaries of existing law.¹⁷ The federal bank regulatory agencies, therefore, retain their 'UDAP' enforcement authority under the FTC Act, while the Bureau will enforce 'UDAAP' within its jurisdiction of depository institutions with more than US\$10bn in assets, and certain institutions such as non-bank mortgage originators and servicers, payday lenders and private student lenders of all sizes.¹⁸

SCOPE OF UDAP/UDAAP RULES

Concepts of UDAP/UDAAP (hereafter referred to as UDAAP) have primarily evolved through regulatory guidance and enforcement actions, which were at their height under the CFPB. In general, principles of UDAAP extend to all retail, small business, and commercial consumers and customers of financial institutions. They apply to all aspects of financial products and services, and extend to acts or practices by affiliates, subsidiaries and third-party service providers.

That means they apply to deposits, lending, product development, fees, changes-in-terms, operations, online activity, ATM machines and all the way through the lifecycle of products and services, including servicing, collections and termination of accounts or services. They include all forms of marketing, solicitation and sales — including print, electronic and social media;

scripts for in-person or telephone sales; as well as other sales practices, incentives and compensation. There are practically no exceptions from UDAAP scrutiny across financial product or services activities.

UDAAP DEFINED

The definition of UDAAP terms is intentionally general within the regulations and guidance, which makes it a challenge for the FI to identify potential UDAAP occurrences. The following definitions should be applied more as aligned with the general intent and purpose of the law, rather than by a strict interpretation. Importantly, UDAAP violations are weighed in relation to the consumer, the impact on the consumer, and critically, the harm or potential for harm to the consumer.

What makes an act or practice 'unfair'?

- It causes, or is likely to cause, substantial injury.
- That could not have been reasonably avoided.
- There are no offsetting benefits to the consumer or competition to justify the act or practice.¹⁹

Unfair acts or practices can involve economic harm, such as errors or omissions relating to fees or rate practices. Adjudication often centres on whether the omission prevented the consumer from having the requisite information to make an informed choice, or to select an option that would have been more favourable. Unfair acts or practices also often occur in conjunction with heavy sales tactics, where consumers are pressured or coerced into products or services they otherwise would have avoided. Other examples include transactions that occurred without a consumer's knowledge or consent. The injury can also be non-economic, however, such as unreasonable harassment during debt collection, where

emotional impacts may contribute to the consumer harm.²⁰

With regard to the ‘substantial’ prong of the test, this could include a small harm to a large number of people, as well as a significant harm to a single individual. Also, the DFA added the phrase ‘is likely to cause’ substantial injury for the definition of UDAAP, so there may be that difference as UDAP is technically applied.

What is a ‘deceptive’ act or practice?

- It causes or is likely to cause substantial injury to consumers.
- The injury is not reasonably avoidable by consumers.
- The injury is not outweighed by counterbalancing benefits to consumers or to competition.

In evaluating ‘deceptive’ acts or practices, it is crucial to evaluate the totality of circumstances from the consumer’s perspective, including implied and express representations, whether verbal or written, as well as omissions. The communication may be considered from the perspective of a reasonable member of the target audience, such as a member of a vulnerable population like older Americans or financially distressed consumers.

Importantly, an intent to deceive is *not* required, and no matter how well-written, disclosures do *not* negate unfair or deceptive statements or captions contained within an advertisement or communication.²¹

What is an ‘abusive’ act or practice?

- It ‘materially interferes’ with a consumer’s ability to understand a product or service.
- It takes ‘unreasonable advantage’ of consumers in some way, as in:
 - a lack of understanding on the part of the consumer of the material risks, costs or conditions of the product or service;
 - the inability of the consumer to protect the interests of the consumer in select-

ing or using a consumer financial product or service; or

- The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.²²

Importantly, the ‘abusive’ standard applies only within the context of UDAAP — it is not applicable in a UDAP analysis. While there have been several cases that have included the ‘abusive’ standard as part of UDAAP enforcement actions, there are no actions that this author is aware of that have been decided solely on this prong. Therefore, there is a general view that the extra ‘A’ does not add significantly to what would or could be decided under existing UDAP standards; however, it is noted that acting Director Mulvaney has signalled an intent to provide more clarity for the ‘abusive’ standard in 2019.

SYNERGY WITH OTHER REGULATIONS

The obligation for a financial institution to avoid UDAAP violations often overlaps with specific requirements in other regulations. Often, a technical violation of one of these other regulations could also trigger an error or omission that may also be viewed as ‘unfair’, ‘deceptive’ or ‘abusive’, and thus enforcement actions may compound penalties based on UDAAP violations. This was especially true of CFPB enforcement actions.

Here are a few examples of closely-related consumer regulations:

- Fair lending laws and regulations, which are designed to ensure equal access to credit and fair treatment in lending activities.²³
- The Truth in Lending Act (TILA or Regulation Z), which is designed to help consumers comparison shop for credit by requiring disclosures about terms and costs.²⁴

- The Fair Credit Reporting Act (FCRA), which is designed to ensure that credit information is reported in an accurate, timely and complete manner, and disputes are promptly investigated.²⁵
- The Fair Debt Collection Practices Act (FDCPA), which prohibits third-party debt collectors from employing deceptive or abusive conduct in the collection of consumer debts.²⁶
- The Electronic Funds Transfer Act (Regulation E), which regulates matters such as fees and error resolution relating to consumer electronic fund transfer transactions.²⁷
- The Telephone Consumer Protection Act (TCPA), which restricts certain unfair or deceptive practices in telephone solicitations and auto dialling systems.²⁸

ESTABLISHING A COMPLIANCE MANAGEMENT SYSTEM

The foundation for a successful, enterprise-wide compliance risk management programme is a robust compliance management system (CMS) appropriate for the size and complexity of the financial institution. A CMS will not always prevent violations, but it will often facilitate early detection of potential violations, which can limit the size and scope of consumer harm.²⁹

This CMS framework includes the concept of the ‘three lines of defence’ risk management model, which helps to clarify roles and responsibilities throughout the enterprise in the management of risk. The first line of defence consists of the business owners, whose role includes identifying risks and obtaining timely assistance from the second line of defence, which includes compliance, legal and risk functions. The third line of defence is comprised of independent assurance providers, such as audit. While small- to medium-sized financial institutions may compress these functions, a mature framework is crucial to

ensure the flow of communication across all three lines, and up to executive management and the board of directors. The CMS also includes the complaint management programme and vendor management programme — both elements that are critical to managing UDAAP risks.

A strong CMS also includes robust UDAAP risk management, which is more challenging than managing other types of regulatory compliance rules, as it is based on principles rather than on technicalities. The culture of compliance around concepts of ‘fairness’ must be more than just top-down; instead, it needs to be recognised and valued by middle management and by every line of business, in order for it to be effective for the financial institution as a whole.

Nowhere has this issue been more evident of late than in the Wells Fargo Bank series of recent consent orders totalling more than US\$1bn, which include penalties for unfair, deceptive and abusive acts and practices.³⁰ The OCC and Bureau specifically found deficiencies in the bank’s enterprise-wide compliance risk management programme relating to unauthorised account openings, unscrupulous sales practices, add-on collateral protection insurance products in auto lending and interest rate lock extensions, to name just a few of the serious violations. In addition to civil money penalties and restitution, the Federal Reserve has also restricted Wells Fargo from growing assets pending improvement in their risk management and corporate governance.³¹ (*The author refers the reader to external materials generally available that are beyond the scope of this paper.*)

UDAAP RISK ASSESSMENT

An essential element of a strong CMS is the risk assessment, and it is becoming more common for FIs to have a focused risk assessment dedicated to UDAAP. This is

supported by a recent survey of US banks and credit unions, which showed that 56 per cent of survey respondents said they were 'somewhat concerned' or 'very concerned about UDAAP'.³²

A UDAAP risk assessment is dedicated to identifying and evaluating UDAAP risks, and includes a focused and realistic assessment of the strength of the associated control environment for mitigating those risks. A good template to follow is the CFPB's consumer risk assessment template available on the CFPB website.³³ Certain industry groups, such as the American Bankers Association, also have UDAAP risk assessment matrices available for their member institutions.³⁴

How these templates are executed in conducting the risk assessment is a key driver in their ultimate efficacy for the enterprise — there should be extensive coordination and communication between the first and second lines of defence to establish the extent of inherent risk, followed by evaluation of the control environment in order to arrive at residual risk.

It is crucial to bring all potential risks and the evaluation of controls from across the enterprise into one central and holistic view, to avoid the silo approach that may have contributed to the problems at Wells Fargo.

At a high level, the UDAAP risk assessment evaluates the following in terms of inherent risks and strength of controls in mitigating those risks:

- The institution's strategic footprint, including the nature and structure of all products and services, including add-on products.
- Preventive controls, such as policies, procedures and training.
- Detective controls, including monitoring, reporting and trend analytics.
- Pricing and profitability models.
- Consumers to whom products and services are marketed, including the number of consumers that could potentially be impacted

or harmed; the type of consumer harm that could occur; and whether they are part of a vulnerable population.

- Incentives and compensation benefits for all sales and account opening practices.
- Marketing, advertising and social media communications across all delivery channels.
- Ongoing customer relationship management and services, from onboarding through collections and account closure.
- Integration of complaints, whistle-blower and exit interview data.
- Third-party vendor activities, especially those with direct consumer or customer contact or interface.
- Operations and systems.
- Compliance management challenges with other regulations, especially those strongly associated with UDAAP issues.
- Overall compliance culture, compliance management system and governance structure, including reporting up to the board of directors and the level of board oversight.
- Other factors that point to heightened consumer risk.

UDAAP RISK ASSESSMENT: OVERALL FOCUS ON CONSUMER IMPACTS

The UDAAP risk assessment is heavily focused on how these risks could potentially affect a consumer, and the evaluation of potential harm. Please note that the term 'consumer' is broader than the term 'customer', as this assessment also includes people who may have been shopping for credit or services as well.

This potential impact or harm can be measured in terms of economic or non-economic harm, direct or indirect harm, short-term or long-term harm, as well as other potential downstream impacts. For example, a system outage could result in just a short-term inconvenience, whereas a more serious injury or loss might relate to system errors, resulting in fees erroneously charged over a period of time.

Non-monetary harm could result from a failure to correct reporting to a credit bureau, and it may have a less harmful impact, such as it may require the consumer to spend significant time to correct. If additional consequences flow from that failure, however, such as a lower credit score that has a downstream effect of a missed employment or apartment opportunity, or higher interest rates for auto or other loans that depend on credit scores, these impacts could be much more serious and longer lasting for the consumer. Thus, all aspects of potential impacts should be fully considered and explored.

Additionally, it is important to evaluate whether the consumer is part of a ‘vulnerable’ population. Here are some factors that may result in more susceptibility to harm:

- Age (both older and younger).
- Financial distress, including unemployment, underemployment or public assistance, and generally less financially sophisticated.
- Non-English speaking or limited English proficiency.
- Active-duty service members.
- Unbanked or underserved.
- Certain disabilities, such as blindness or deafness.³⁵

UDAAP RISK ASSESSMENT: INHERENT RISK FACTORS

The evaluation of inherent risk includes UDAP and UDAAP risks from regulations, guidance and enforcement actions of the federal regulatory agencies, as well as from states that may have their own UDAP and related consumer laws, such as usury laws. As mentioned, UDAAP risks have been developed primarily through enforcement actions, so it is crucial to study them carefully. A key enforcement action could indicate the start of a trend, and it is often likely these trends will be top of mind for examiners for an FI’s upcoming exam. For example, following the Wells Fargo

enforcement actions, the Federal Reserve Board found several systemic issues relating to sales abuses at other banks.³⁶ A detailed review of enforcement activity is beyond the scope of this paper.

In general, an evaluation of inherent risks includes an assessment of public enforcement actions, as well as regulatory communications related to those risks, especially now given the recent changes of the heads of many federal regulatory agencies in the USA. Also consider the FI’s compliance history related to these risks, including findings by the three lines of defence, external auditors and from regulatory exams, as well as data from the FI’s complaint management programme. Other factors include the degree of complexities and interdependencies across products, services or processes, especially those that require interaction between multiple technology systems, groups, partners and/or legal entities. Also consider the extent to which critical or key activities are conducted by third-party vendors, and the involvement of new fintech technologies.³⁷

As discussed, all UDAAP risk assessments focus heavily on risks to the consumer, and this is often aligned with the evaluation of reputation risks. Finally, key metrics are critical in the assessment of risk — what are the occurrences of process, transaction or customer volumes, and do they occur with every transaction, only in a certain lifecycle phase (such as account opening), and/or can they be measured as a daily, weekly, monthly or annual occurrence? These metrics are important to help trend activity and business changes year over year, and are important to flag increasing or decreasing risk.

UDAAP RISK ASSESSMENT: RESIDUAL RISK AND THE CONTROL ENVIRONMENT

Ultimately, residual risk is determined by accurately measuring the efficacy of the control environment in mitigating inherent

risks. In general, enterprise controls can be distinguished as follows:

- *Preventive controls*, such as policies, procedures, training and general compliance risk management and board/senior management oversight. Preventive controls can also include third-party vendor due diligence activities.
- *Detective controls across the three lines of defence*, such as line of business testing, compliance monitoring and audit. Detective controls can also include monitoring complaints from all sources, analysing trends and conducting root cause analysis to ensure corrective actions are applied at the source of issues. These can also include third-party vendor monitoring activities.
- *UDAP/UDDAP-specific controls* include controls around UDAAP high-risk areas, including new product development (including add-on products), advertisements and solicitations, and sales incentive practices and programmes, through to customer service, collections and account closure. The remainder of this paper will focus on practical approaches for implementing effective UDAAP controls, especially within the first and second lines of defence.

UDAAP CONTROLS: SOFT SKILLS

An overall essential part of establishing a strong CMS system of controls for UDAAP is having a culture that aligns with the unique compliance skills needed to manage the subjective and ill-defined nature of UDAAP risks. The culture of compliance around UDAAP needs to have talented professionals throughout the first and second lines of defence who have developed what are commonly termed ‘soft skills.’ At the first line of defence, especially at the middle management level, there can sometimes be a myopic focus on the bottom line, with compliance responsibilities viewed as a necessary but rather disdained

cost of doing business. The line of business needs to be ‘sensitive’ to how products and services could potentially be unfair, deceptive or abusive when viewed from the perspective of the consumer. Likewise, at the second line of defence, subject matter expertise and knowledge of the tenets of compliance are viewed as the primary importance. Nevertheless, skills that have historically been viewed as ‘soft skills’, such as collaboration, communication and teamwork, are of vital importance to an FI’s UDAAP risk management programme, because there is no black or white, check-the-box approach to managing UDAAP. For example, the second line needs to be a part of product development and associated marketing to truly understand if marketing might be misleading in relation to how a product actually works. These skills are also increasingly viewed as essential in building a sound compliance culture throughout the enterprise, but they are key controls for managing UDAAP risks.³⁸

UDAAP CONTROLS: PRODUCT DEVELOPMENT, INCLUDING ADD-ON PRODUCTS

Historically, there have been a lot of UDAAP enforcement actions involving product terms and pricing, and in particular around add-on products. Credit card add-on products/services are such things as identity theft protection or types of insurance (eg, car rental insurance). Auto lending add-on products can also include credit protection products or insurance products. The FI should have a good understanding of the product that is offered in relation to the intended market by evaluating the following:

- Target market — identify vulnerabilities that expose UDAAP risks.
- Product terms and limitations — are they fair and easily understood/achievable?

- Pricing strategy — all potential fees should be considered.
- Add-on products — are the benefits real? Will charges start in alignment with programme benefits, are charges fully understood and will charges stop in alignment with a consumer's decision to exit the add-on?
- Profitability goals — profitability should not be dependent on late fees or other consumer burdens.
- Consumer benefits — ensure that benefits are real, well-documented and minimise the risk of consumer harm.
- Third party involvement — proactively identify all points of consumer interface or potential impact, particularly if another vendor is administering an add-on product.
- Operational systems — what is the risk of harm to consumers for system failure?
- Timing of launch — be sure key resources are available for customer support.

One of the best overall controls for the line of business (LOB) is to have a second-line compliance officer (CO) as a strategic partner throughout all key points of decision-making for any new product or service. Compliance should have a seat at the table early, and be invited to all milestone meetings.

Compliance should align with the overall FI's need to grow, which entails new products, services and partnerships, while mitigating risk with well-placed controls. In order to fully understand how to position controls, the CO may need to listen more, and consider the 'right' amount of content to provide at a general meeting. Often it may be more prudent to have offline discussions with key stakeholders to work through and find solutions for compliance needs and concerns. The business can also identify a UDAAP 'compliance liaison' to spend the much-needed time with compliance to work through solutions as the product is developed.

If compliance is accepted as a team player, compliance will have a much better understanding of how the new product or service is intended to work, can build in controls as the product is being developed, and will also have a better context for reviewing associated marketing materials and collateral. Additionally, compliance should reinforce best practices with positive feedback, and add energy and excitement in support of new initiatives. By cultivating strong relationships with the LOB, a strong culture of compliance will be built-in as a part of the new product or service offering that will help to mitigate UDAAP risks.

UDAAP CONTROLS: ADVERTISING, MARKETING AND PROMOTIONS

A collaborative team approach between the business and compliance is essential to understand the context of marketing collateral, in order to weigh UDAAP risks. Too often, compliance reviews an advertisement or disclosure in isolation, without truly understanding how the product or service is intended to work. In other instances, compliance is brought in at the very end of the creative process, after a significant investment in creative agencies, and tears apart the creative due to the need for lengthy disclosure or other compliance concerns. These results can be avoided if compliance is brought in as a strategic partner early in the creative process, and kept apprised of key developments so the final approval goes smoothly.

In general, these are useful tips to mitigate UDAAP risks in marketing communications:

- Tailor the content to the target market — avoid complexities.
- Use 'full and prominent' disclosures.
- Disclose any limitations on the applicability of the offer.

- Avoid false impressions — disclose limited durations, fees and costs.
- Advertise real benefits completely and accurately.
- Evaluate the entire campaign.
- Ensure that all relevant staff are fully informed to address questions at launch.
- Ensure that customer service is prepared to handle inquiries.
- Take steps to align customer feedback or complaints with the collateral or product.
- Measure the response of the campaign and correlate with expectations — for example, did a significant portion of customers achieve the ‘up to’ credit limits advertised?

Another useful approach for mitigating advertising UDAAP risks is by paying attention to what are known as ‘The Four Ps’ relating to clear and conspicuous disclosures:

- *Prominence*: Is it big enough for consumers to notice and read?
- *Presentation*: Is wording and format easy for consumers to understand?
- *Placement*: Is it where consumers will look?
- *Proximity*: Is it near the claim that it qualifies?³⁹

As a practical matter, a three-part approach to marketing controls can work well for mitigating UDAAP risks:

- (1) *Embed a compliance approval tracking system within the LOB* — Marketing collateral needs to be organised and retained in a consistent manner, so it is logical to embed this control in the line of business to ensure that they receive written compliance approval on the ‘final’ collateral (which includes any conditions or mandated changes by compliance); and also include the collateral, along with the approval within the system of record. It is also helpful to have a simple, standard *Compliance Approval Request Form* that documents certain key elements of context

around the marketing campaign and use of the collateral, which can also be retained with the final collateral and approval.

- (2) *Develop sample disclosures* — Compliance can work with the LOB to develop a ‘disclosure bank’ that will document: ‘*If you say this {trigger term}*’; ‘*Then use this {disclosure}*.’ The disclosure bank can be a simple Excel document that has tabs for each major product or service line, and contains commonly used disclosures. It is very helpful for new marketing personnel (where turnover can be frequent) and to promote consistency for the enterprise as a whole. Specific to disclosures, consider the following to be sure all details of an offer are complete, accurate, fair, and not misleading or abusive:
 - State any limitations to the offer, such as an expiration date.
 - List all qualifications to obtain the offer.
 - Explain if there is a ‘go-to’ rate after the promotional period ends, and how that will work in practical terms for the consumer.
 - Be sure all claims are substantiated and verifiable; all advertised benefits are actual, likely and real; and the overall impression is reasonable and accurate.
 - Remember that no matter how well written, disclosures do not negate unfair, deceptive or abusive statements or captions contained within an advertisement or marketing campaign.
- (3) *Create practical policies, procedures, field guides and training* — Compliance can again work with the LOB to define UDAAP in terms of common examples, so it can be easily understood by marketing personnel, many who may be junior and/or new to banking. These documents can serve as easy-to-read reference materials that can be customised for issues/complaints common to the FI, and updated regularly for ‘hot topics’ across UDAAP. This guidance should explain conditions, qualifications or restrictions that the LOB should be

aware of in constructing offers or promotions, and the approving compliance officer would want to know about for approvals, such as:

- *Duration of offer* — including specific expiration dates.
- *Use restrictions*—such as ‘*not applicable to existing customers*’ or ‘*cannot be combined with any other discount or promotion*’.
- *General restrictions* — such as ‘*terms and conditions subject to change*’ or ‘*offer void where prohibited by law*’.
- *Assumptions underlying ad statements* — such as ‘*APR may increase*’.
- *Geographic restrictions* — such as ‘*not available at all branches*’ or ‘*only available in {State X}*’.
- *Account/product restrictions* — such as ‘*applies only to {personal or business} accounts*’.
- *Qualifications on offer availability* — such as ‘*minimum opening deposit of {amount};*’ ‘*subject to verification of {condition};*’ or ‘*subject to credit approval*’.
- *Coupons and certifications* — such as ‘*one certificate per household*’ or ‘*coupon is not transferable*’.

These tactics can go a long way to help mitigate risk and enhance the control framework around an area that is a frequent source of UDAAP issues and concerns.

UDAAP CONTROLS: TELEMARKETING/ CUSTOMER SERVICE/COLLECTIONS

UDAAP issues are a concern wherever there is an interface with consumers, and that is a common occurrence when employees or third-party vendors are talking to consumers/customers on the telephone, and especially when selling products, services or add-on products; or calling about late payments or a debt. To control for UDAAP risks, develop comprehensive scripts, train personnel and monitor the calls. It is important to have frequent monitoring to detect any

individual who may have trouble following the script or adhering to procedures and guidelines, as this could be problematic if allowed to continue. Therefore, it is crucial for the line of business to assume responsibility for frequent monitoring, maintain key metrics (such as number of complaints per representative), and immediately address any issues. Second-line monitoring and third-line audit should supplement LOB monitoring.

SALES INCENTIVES/PRACTICES

As discussed earlier, the Wells Fargo cases have brought to light many types of issues surrounding sales tactics and over-aggressive sales practices. Overall, the FI should ensure that all sales targets and incentives do not encourage harmful behaviour. Sales can be directed to focus on the needs of the consumer to sell or cross-sell, which may be a shift from product-focused metrics. Customer-oriented metrics can include customer surveys/complaints, as well as employee surveys, ethics hotline feedback and integration of any information coming from whistle blowers, exit interviews or other information through human resources. Monitoring of key metrics can be done for suspicious patterns of sales activity, such as when a second or third checking product is opened within days of each other, or a sudden increase or spike occurs in new accounts at the end of a business cycle for a particular sales representative.

Recent enforcement actions highlight how important it is for human resources personnel to understand the information they are receiving so they can make informed decisions on how and when to escalate to compliance, legal, senior management and the board. It is crucial that human resource personnel receive UDAAP training, and also have a good working relationship with compliance so they can communicate concerns as appropriate.

UDAAP CONTROLS: COMPLAINT MANAGEMENT

Possibly one of the most important UDAAP risk management tools is a robust complaint management programme. A good programme will capture consumer complaints from all channels, and appropriately identify, record and categorise the complaints. Those complaints with fact patterns suggesting potential harm from unfair, deceptive or abusive treatment should be escalated to compliance/legal for further evaluation. Complaints should be timely investigated for root cause and impact to consumers, and timely resolved with appropriate corrective and/or remediation actions. All complaint data should be analysed to detect trends, and there should be prompt integration of all process improvements, driven by increasing trends to improve business practices, systems, controls, policies, procedures and training.

The following are frequent triggers that could suggest a UDAAP issue if the complaint involves allegations of:

- Receipt of misleading or false statements.
- Missing disclosures or information.
- Undue or excessive fees or rates.
- Inability to reach customer service (or a live person).
- Undisclosed or unauthorised charges.
- Products geared towards the ‘vulnerable’ — students, elders, service members, those in financial distress, those with limited English skills or education.
- A statement to the effect of ‘I didn’t understand’.

CONCLUSION

UDAAP compliance risks are the most challenging risks to identify and manage effectively. Those financial institutions that make a commitment to a culture of fairness to all consumers will take proactive steps to mitigate risks associated with UDAAP issues

and concerns throughout the life cycle of its products and services. A comprehensive UDAAP risk assessment — with a strong network of controls — is an integral part of a comprehensive compliance management system that should help financial institutions be successful in UDAAP governance.

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