Unfair, Deceptive or Abusive Acts or Practices (UDAAP) is one of the most talked about compliance issues today. With the passage of Dodd-Frank, UDAAP has expanded to incorporate a new standard with the addition of the term “Abusive,” and in so doing thrust this consumer protection issue further into mainstream consciousness. This renewed focus on UDAAP has created a heightened regulatory concern for banks and other financial institutions governed by the Consumer Financial Protection Bureau (CFPB), particularly due to the lack of certainty behind how the term “Abusive” will be incorporated into financial services supervision.

While the regulation of unfair and deceptive acts dates back to 1938 with the enactment of Section 5 of the Federal Trade Commission (FTC) Act, the banking regulators have once again started to leverage this law more aggressively as a way to enforce consumer protections as we continue to recover from the financial crisis of the past decade. Today, all banking regulators can, and likely will, still be involved in UDAAP enforcement, but the passage of Dodd-Frank granted the CFPB the right to regulate and take enforcement actions against unfair, deceptive and abusive acts or practices. Over the past two years, the CFPB has begun to clarify their interpretation and enforcement of UDAAP. Three key activities from the CFPB specifically have provided greater guidance and insight:

1. On October 13, 2011, the CFPB published the Supervision and Examination Manual that provides standards the CFPB will use to assess whether an act or practice is unfair, deceptive or abusive, as well as historical examples of each. While unfair and deceptive standards were based on historic definitions, the manual serves as today’s current guide on how these requirements will likely be evaluated;

2. In June 2012, the CFPB was the first regulator to publish an online database of consumer complaints and has made available all credit card complaints for CFPB regulated institutions; and

3. In the Summer and Fall of 2012, the CFPB issued enforcement actions against three of the top ten credit card providers. These enforcement actions are primarily based on the “unfair” and “deceptive” standards within UDAAP but still provide some guidance as to how the CFPB, in partnership with the other regulators, will enforce consumer protections relating to these standards.

Each of these events sketch what the future holds for consumer-focused regulatory oversight. In this paper, we will consider what each of these events indicates for the future of the financial services industry and how they are actionable today. The financial services industry is monitoring these actions and looking to define best practices in an effort to be consumer friendly, while also trying to prevent any regulatory actions or reputational impact.
How to “Adaapt” to UDAAP

Looking Back – CFPB Publishes UDAAP Guidance

When the CFPB published their UDAAP examination guidelines and procedures, they laid out definitions of the terms Unfair, Deceptive and Abusive with examples to help illustrate these terms as seen in the table below. Much of this was based on or informed by previous regulatory work of the other federal banking regulators, as well as standards defined by the Federal Trade Commission, but it provides a clear outline of the current interpretation and requirements:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Official Definition</th>
<th>Explanation</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unfair</td>
<td>It causes or is likely to cause substantial injury to consumers</td>
<td>Usually monetary. “Substantial” can be by individual dollar amount or number of customers impacted.</td>
<td>1. Refusing to release lien after mortgage is paid off (Capital City Mortgage Corp., 2005)</td>
</tr>
<tr>
<td></td>
<td>The injury is not reasonably avoidable by consumers</td>
<td>Does an act or practice hinder the ability of the customer to make a better choice? Do the customers have an opportunity to make a choice before committing?</td>
<td>2. Dishonoring Credit Card Convenience checks without notice (American Express, 2009, lowered credit limits after initial offer)</td>
</tr>
<tr>
<td></td>
<td>The injury is not outweighed by countervailing benefits to consumers or competition</td>
<td>Examples of benefits would be overall lower prices to consumers, or wider availability of products and services</td>
<td>3. Processing payments for companies engaged in fraudulent activities (Wachovia Bank)</td>
</tr>
<tr>
<td>Deceptive</td>
<td>The representation, omission, act or practice that misleads or is likely to mislead the customer</td>
<td>The four &quot;P&quot;s to test a statement. Is it Prominent, Presented in an easy-to-read format, Placement in an accessible location, and in Proximity to the claim it qualifies</td>
<td>1. Inadequate disclosure of material lease terms in television advertising (Multiple auto lenders – blur of onscreen terms)</td>
</tr>
<tr>
<td></td>
<td>The consumer’s interpretation of the representation, omission, act or practice is reasonable under the circumstances</td>
<td>Is at least a significant minority, if not a majority of the target market able to interpret it in the deceptive manner?</td>
<td>2. Misrepresentation about loan terms</td>
</tr>
<tr>
<td></td>
<td>The misleading representation, omission, act or practice is material</td>
<td>Is the information important to the consumer’s choice? (i.e. cost, benefits, or restrictions)</td>
<td></td>
</tr>
<tr>
<td>Abusive</td>
<td>Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service</td>
<td></td>
<td>No Examples Provided in CFPB Manual*</td>
</tr>
<tr>
<td></td>
<td>Takes unreasonable advantage of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>■ A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>■ The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>■ The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: CFPB Supervision and Examination Manual

*The CFPB Supervision and Examination Manual does not provide examples of abusive acts or practices. The agency is considering facts and circumstances of individual situations and it is reasonable to anticipate more to come on what the CFPB will consider an abusive act or practice.
Using Compliance Governance to Stay Ahead of the Evolving UDAAP Guidelines

In addition to defining the component standards of UDAAP, the manual includes a section on the role of complaints and how they can serve as a key indicator of unfair, deceptive or abusive acts or practices. The CFPB has raised the tracking and analysis of complaint data to a higher level of importance and scrutiny than previously seen in banking supervision through the publication of the data along with access to analytical tools. Historically, banks have been required to track public complaint data for CRA purposes, but this was limited to those that related to performance in helping to meet community credit need. Most institutions have also monitored third-party complaint sources, such as the Better Business Bureau and Office of the Attorney General, in an effort to manage reputational risk. However, with the CFPB actively soliciting complaints from consumers and raising awareness in the industry through the publication of the Consumer Complaint Database, complaint management has been elevated to a more attention-getting level. The CFPB provides public access to the database in a manner that enables users to download, search, and visualize complaint data.

The reaction has been strong. By only publishing credit card complaints, many institutions likely feel they were unfairly represented within the particular data set selected, while others may be happy to come off relatively unscathed. On the other hand, many consumer advocates are eager to have the data made public and are continuing to push for an expansion of this transparency. The existing data set represents a small percentage of the overall number of complaints collected to date by the CFPB. The CFPB, in initial examinations, was not only interested in the complaints reported to them, but also, and more particularly, how financial institutions are handling and responding to complaints that are directly issued to them. This is a paradigm shift from a regulatory perspective, in that financial institutions must now:

- Have effective, demonstrable processes established to track all verbal, written and third-party complaints
- Ensure a timely response to those complaints
- Analyze complaint trends for any indication of potential UDAAP issues
- Identify root cause along with efforts to establish controls to mitigate recurrence going forward

Because the CFPB views response to consumer complaints as one of the four interdependent parts of a conforming compliance management system, financial institutions must incorporate analyses of and responses to complaint data into their consumer risk assessment and monitoring controls established to prevent recurrence of cited issues going forward.

As mentioned earlier, three top credit card lenders were recently hit with significant UDAAP-related enforcement actions. These actions send a powerful message to the industry about what the CFPB, working hand-in-hand with the prudential regulators, is looking at in relation to UDAAP and should help other institutions to understand regulatory expectations. Each of the actions emphasized misleading advertising and sales practices that need to be corrected as indicated by the headlines and news story excerpts below.

| Capital One | Capital One will "refund approximately $140 million to two million customers and pay an additional $25 million penalty. This action results from a CFPB examination that identified deceptive marketing tactics used by Capital One's vendors to pressure or mislead consumers into paying for 'add-on products' such as payment protection and credit monitoring when they activated their credit cards." |
| American Express | “CFPB orders American Express to pay $85 million refund to consumers harmed by illegal credit card practices…. Deceived consumers who signed up for …. credit card program” |
| Discover | “Discover will refund approximately $200 million to more than 3.5 million consumers who purchased add-on products between December 1, 2007 and August 31, 2011…. Telemarketing scripts contained misleading language likely to deceive some consumers about whether they were actually purchasing the product.” |
How to “Adapt” to UDAAP

Looking Forward – Complying with UDAAP

Like all things related to regulatory risk and compliance, the best practice for creating a UDAAP-conscious organization is to establish the tone for compliance at the top of the organization. Financial institutions are well-advised to review what is being communicated downward through various means, particularly in the form of policies, procedures and training materials. Furthermore, financial institutions should always strive for fairness and transparency when communicating product features, terms and costs to customers, and likewise apply the same standard in the delivery, support and servicing of all products. When reviewing your company’s compliance efforts with respect to UDAAP, there are a few key considerations critical to achieving a strong UDAAP compliance culture. Consider the full extent of the product lifecycle when assessing your UDAAP compliance risks. High risk areas to focus on are:

Advertising and Solicitations. The importance of an advertising review by Legal and Compliance, both for internally generated marketing messages, sales training, and advertising content, as well as advertising and sales messaging created by third parties cannot be emphasized enough. Meet with the marketing, advertising, and product managers for each business unit or product line to gain a thorough understanding of their product development, marketing, advertising, and customer solicitation activities. It is in this process that you can explain the impact and importance of UDAAP, the heightened regulatory focus and expectations, and what product managers and marketers need to consider when creating messaging and content to drive new business. Where the message is delivered by individuals acting in a customer service, cross-sell capacity, look closely at the training and the level of scripting provided to customer-facing personnel designed to maintain consistency and accuracy of presentation with respect to the product terms and conditions. Keep in mind that advertising content must be complete, accurately represent the product or service offering, and in the end be designed to help the consumer make an informed decision.

Loan and Account Disclosures. Similar to the exercise described above for advertising and solicitations, institutions must first meet with representatives of each business and product line to review loan and account disclosures for compliance with applicable laws and regulations. It is critically important to compare the information disclosed to actual practices and to the associated advertising and solicitation materials to assess overall alignment of product, product delivery and support activities, as well as how each is disclosed and presented to the public. It is paramount to stress absolute transparency in all aspects of the product lifecycle and for each business line and product group to continuously review for technical accuracy, alignment to actual practices, and clarity and ease of understanding from the consumer’s point-of-view.

Servicing and Collections. Whether you service and collect on your own loans or perform this activity for other parties, understand that how established accounts are handled from a servicing and collections perspective is an area of great interest to regulators, particularly with respect to fairness and transparency. In promoting UDAAP compliance, you should meet with servicing and collections management to review scripts used by department personnel to confirm that they comply with applicable laws and regulations, and that personnel receive proper training and support to fulfill their responsibilities. To ensure that servicing and collections activities are accurately fulfilled, monitor customer calls and correspondence to assure that payments are processed correctly, that allowable fees are collected, and debt collection practices are in accordance with legal requirements, as appropriate.

Third-Party Service Provider Oversight. Work performed on behalf of your company by third-party service providers should be viewed no differently than work performed by your own employees when it comes to UDAAP, or any other legal or regulatory requirement. It is very important to fully integrate third-party service provider oversight into your compliance management system. Each business and functional unit must be held accountable for following established standards for risk assessment, due diligence, contracting and onboarding, and continuous monitoring of third-party service providers once the relationship is up and running.

Complaint Management—How Do You Measure Up?

With the CFPB actively soliciting complaints from consumers and using that data to support their supervisory activities, you need to take a close look at your complaint data management and response processes. Particular attention should be paid to:

■ Your definition of a complaint
■ How complaints are categorized and classified internally
■ How they are routed for analysis and identification and analysis of root cause, formal response, and ultimate resolution

Generally a complaint is a written expression of dissatisfaction with or allegation of wrongdoing by a provider of any financial product or service or any entity subject to regulation or supervision by the Bureau or a Prudential Regulator made by a Consumer (including a representative acting on behalf of a Consumer). Furthermore, it can be an allegation by or on behalf of an individual, group of individuals, or other entity that a particular act or practice of a regulated entity is unfair or deceptive, or in violation of a regulation or any other act or regulation under which a bank must operate.

An effective complaint management system must be able to receive and process complaints from all sources, ranging from complaints issued directly to the bank to complaints from external sources.
such regulators, attorneys, the Better Business Bureau, consumer protection groups, and web-based sources and social networking media. Complaints, while often troubling, are an opportunity to detect and address UDAAP issues such as false or misleading statements, inaccuracies in disclosures, excessive and/or previously undisclosed fees, misunderstandings around product benefits or rewards, issues with customer services or other problems not previously detected. Keep in mind that third-party service providers performing services on behalf of your organization should have conforming processes in place to receive complaints that mirror your own complaint handling processes. Complaint management should be integrated as part of your ongoing third-party service provider oversight and performance monitoring activities.

Risk Assessments – The Shift

For years, financial institutions have been conducting risk assessments based on traditional risk disciplines such as credit risk, operational risk, reputation risk; and asking themselves what the risk to the institution is if a compliance violation occurs. The CFPB’s consumer-centric approach has turned this model upside-down and is now focusing on the inherent risk to the consumer for any given process or product. This is a major shift in how institutions are being asked to examine risk, essentially creating a new risk discipline. Expect the CFPB to focus their examinations on the processes and products that have an ability to harm the consumer. Financial institutions subject to CFPB supervision are, as part of the Agency’s process of building an entity profile, advised to have a consumer risk assessment as part of the supervisory process. The CFPB has provided a template for the consumer risk assessment in the Appendix to the Supervision and Examination Manual.

Managing UDAAP Going Forward

In applying practical thinking to managing UDAAP compliance risk and considering the high risk areas discussed above, does your compliance management system:

- Establish compliance responsibility and accountability for UDAAP compliance at all levels of the organization?
- Communicate to all employees, as appropriate, their responsibility for compliance with UDAAP through training and regular compliance updates?
- Ensure that UDAAP requirements are incorporated into the everyday business processes, as well as the procedures followed by contractors and third-party service providers?
- Review operations for compliance with UDAAP requirements?
- Require corrective action when non-compliance or a potential weakness is identified?

Clearly, the desirable answer to each of the above-listed questions is yes.

The key to establishing an effective UDAAP compliance program within the framework of your compliance management program is having strong controls. The CFPB prescribes the following four interdependent control components:

- Board and Management Oversight
- Compliance Audit
- Formal Compliance Program (i.e., policies and procedures; training; and monitoring corrective actions)
- Response to Consumer Complaints

If you have not already taken a hard look at where your organization stands with respect to UDAAP, the time for action is now. As noted above, the CFPB is taking action against financial institutions and it is reasonable to expect more of the same to follow. Many financial institutions are struggling with UDAAP compliance due to its highly subjective nature. Understanding where you stand with your efforts to comply with UDAAP will require introspection and careful analysis of how your organization communicates both internally and externally and understanding whether it is being fair, transparent, and accurate in all dealings and transactions with consumers.
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