

UNFAIR AND DECEPTIVE ACTS AND PRACTICES DEVELOPMENTS IN THE FINANCIAL SERVICES INDUSTRY

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The authors explain how unfair and deceptive acts and practices (“UDAP”) laws have been applied to institutions in the financial services industry and the manner in which the regulation and enforcement of UDAP is evolving in the current economic climate by way of proposed regulations and legislation, and they offer suggestions for best practices for institutions to consider to ensure compliance with UDAP laws.

The Federal Deposit Insurance Corporation (“FDIC”) recently roused the attention of the financial services community when it issued enforcement actions against CompuCredit Corporation and two FDIC-supervised banks for allegedly marketing subprime credit cards in violation of the Federal Trade Commission Act (“FTC Act”).¹ The enforcement actions sought orders that would correct the FTC Act violations and would provide restitution to consumers in the form of credits for certain fees and charges arising from deceptive marketing practices. These credits were estimated to exceed \$200 million dollars. The FDIC also sought civil money

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penalties from the three institutions. In addition to the significant credits and penalties at hand, the three institutions faced immeasurable harm to their business reputations.

Federally regulated financial institutions have long been subject to unfair and deceptive acts and practices (“UDAP”) laws by way of the FTC Act. In recent years, amidst inquiries into aggressive lending practices and increased scrutiny on the credit card industry, the enforcement of UDAP laws has intensified and there has been a significant push by banking regulators and Congress to impose stricter UDAP standards on financial institutions. This article provides a summary of the following: (i) how UDAP laws have been applied to institutions in the financial services industry, (ii) the manner in which the regulation and enforcement of UDAP is evolving in the current economic climate by way of proposed regulations and legislation, and (iii) suggestions for best practices for institutions to consider to ensure compliance with UDAP laws.

APPLICATION OF UDAP LAWS TO INSTITUTIONS IN THE FINANCIAL SERVICES INDUSTRY

Section 5 of the FTC Act states that the FTC is “empowered and directed to prevent persons, partnerships, except banks, saving and loan institutions...[and] Federal credit unions...from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.”² To prevent UDAP, the FTC Act requires each bank regulator, including the FDIC, the Board of Governors of the Federal Reserve System (“Federal Reserve”), the Officer of the Comptroller of the Currency (“OCC”), the Office of Thrift Supervision (“OTS”) and the National Credit Union Administration, to establish a division of consumer affairs to receive consumer complaints and to take appropriate action in response to such actions or practices on the part of the institutions they regulate.³ Each of these bank regulators may enforce these regulations pursuant to a provision in the Federal Deposit Insurance Act (“FDI Act”) which provides bank regulators with enforcement authority.⁴

In 2002, the FDIC stated that in order to determine whether a practice is unfair, it will consider whether the practice “causes or is likely to cause sub-

stantial injury to consumers which is not reasonably avoided by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.”⁵ The FDIC also stated that deceptive trade practices include “representations, omissions, or practices that are likely to mislead consumers acting reasonably under the circumstances, and are likely to cause such consumers harm.”⁶ In 2002, the OCC provided similar guidance,⁷ which came shortly after a settlement with First National Bank of Marin, Las Vegas in late 2001 in which the OCC for the first time used its authority under the FTC Act to take action against a bank that it determined had engaged in unfair and deceptive practices in connection with its marketing of credit cards to consumers with poor credit histories.⁸ In 2004, the Federal Reserve and the FDIC issued joint guidance on UDAP, reinforcing previous pronouncements and providing best practices to address areas they perceived to be most likely to generate UDAP, including advertising and solicitation, servicing and collections, and the management and monitoring of employees and third-party service providers.⁹

As demonstrated by the FDIC enforcement actions taken against CompuCredit Corporation, a non-FDIC-supervised institution that the FDIC classified as an “institution-affiliated party” under the FDI Act, UDAP laws may have a significant impact on third party relationships, even if such third parties are not directly supervised by banking regulators.¹⁰ Generally, third parties that perform internal operations for supervised banks are subject to the Bank Service Company Act, which states that banking regulators have the authority to examine and to regulate the functions or operations performed or provided by third-party servicers to the same extent as if they were performed by the bank itself on its own premises.¹¹ Thus, the board and management of supervised banks are responsible for adequately managing third-party relationships and identifying and controlling the risks that can arise from them. In 2001, the OCC provided guidance to banks on mitigating the risks that may arise from business relationships with third parties.¹² The guidance provided risk management principles, including:

- Risk assessment considerations,
- Third party selection and due diligence techniques,

- Contract issues, and
- Oversight procedures.

THE EVOLUTION OF UDAP LAWS

Inquiries into aggressive lending practices and increased scrutiny on the credit card industry has led to other pronouncements about UDAP in recent years. The FDIC enforcement actions against CompuCredit Corporation and the two banks came on the heels of proposed rules issued by the Federal Reserve on May 19, 2008 that would prohibit unfair practices in the credit card industry, which included the following:

- Forbidding banks from imposing interest charges using the “two-cycle” billing method,
- Requiring that consumers receive a reasonable amount of time to make their credit card payments,
- Prohibiting the use of payment allocation methods that unfairly maximize interest charges, and
- Requiring protections for consumers that use overdraft services offered by their bank.¹³

These proposed rules would amend the Federal Reserve’s Regulation AA (Unfair and Deceptive Acts or Practices) as well as Regulation Z (Truth-in-Lending Act) and Regulation DD (Truth-in-Savings Act). The Federal Reserve has asked for public comments on the changes to Regulation AA by August 4, 2008 and to Regulation Z and Regulation DD by July 18, 2008.

The Federal Reserve proposed rules under the Home Ownership and Equity Protection Act on December 17, 2007 to limit unfair and deceptive practices in mortgage lending.¹⁴ In Congress, both houses have set forth legislation to strengthen the rulemaking authority of the banking regulators to enable better and more consistent enforcement of UDAP laws.¹⁵ A number of states have enacted UDAP legislation and have actively pursued UDAP violations, but state regulators have expressed some frustration that certain

state consumer protection laws have been preempted by federal laws and regulations.¹⁶

BEST PRACTICES TO CONSIDER TO ENSURE COMPLIANCE WITH UDAP LAWS

Bank regulators have set forth a nonexhaustive list of best practices for institutions to consider to avoid engaging in unfair or deceptive activities:

- Review all promotional materials, marketing scripts, and customer agreements and disclosures to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered, including any related or optional products or services, and that they do not misrepresent such terms either affirmatively or by omission. Ensure that these materials do not use fine print, separate statements or inconspicuous disclosures to correct potentially misleading headlines, and ensure that there is a reasonable factual basis for all representations made.
- Draw the attention of customers to key terms, including limitations and conditions, that are important in enabling the customer to make an informed decision about a product.
- Clearly disclose all material limitations or conditions on the terms or availability of products.
- Inform consumers in a clear and timely manner about any fees, penalties, or other charges that have been imposed, and the reasons for their imposition.
- Clearly inform customers of contract provisions that permit a change in the terms and conditions of an agreement. When using terms such as “pre-approved” or “guaranteed,” clearly disclose any limitations, conditions, or restrictions on the offer.
- Clearly inform consumers when the account terms approved by the bank for the consumer are less favorable than the advertised terms or terms previously disclosed.

- Tailor advertisements, promotional materials, disclosures and scripts to take account of the sophistication and experience of the target audience. Do not make claims, representations or statements that mislead members of the target audience about the cost, value, availability, cost savings, benefits, or terms of the product or service.
- Avoid advertising that a particular service will be provided in connection with an account if the bank does not intend or is not able to provide the service to accountholders. Clearly disclose when optional products and services — such as insurance, travel services, credit protection, and consumer report update services that are offered simultaneously with credit — are not required to obtain credit or considered in decisions to grant credit.
- Ensure that costs and benefits of optional or related products and services are not misrepresented or presented in an incomplete manner.
- When making claims about amounts of credit available to consumers, accurately and completely represent the amount of potential, approved, or useable credit that the consumer will receive.
- Avoid advertising terms that are not available to most customers and using unrepresentative examples in advertising, marketing, and promotional materials.
- Avoid making representations to consumers that they may pay less than the minimum amount due required by the account terms without adequately disclosing any late fees, overlimit fees, or other account fees that will result from the consumer paying such reduced amount.
- Clearly disclose a telephone number or mailing address (and, as an addition, an email or website address if available) that consumers may use to contact the bank or its third-party servicers regarding any complaints they may have, and maintain appropriate procedures for resolving complaints. Consumer complaints should also be reviewed by banks to identify practices that have the potential to be misleading to customers.
- Implement and maintain effective risk and supervisory controls to select and manage third-party servicers.
- Ensure that employees and third parties who market or promote bank

products, or service loans, are adequately trained to avoid making statements or taking actions that might be unfair or deceptive.

- Review compensation arrangements for bank employees as well as third-party vendors and servicers to ensure that they do not create unintended incentives to engage in unfair or deceptive practices.
- Ensure that the institution and its third party servicers have and follow procedures to credit consumer payments in a timely manner. Consumers should be clearly told when and if monthly payments are applied to fees, penalties, or other charges before being applied to regular principal and interest.

To the extent applicable, the recommendations above should be adopted as part of a comprehensive compliance program.

CONCLUSION

Institutions that do business in and provide services to the financial services industry should remain informed of UDAP developments to confirm that they are in full compliance with UDAP laws. Institutions that will be subject to the proposed rules discussed in this article should carefully consider the proposals both with an eye to providing appropriate comment and to ultimate compliance.

NOTES

¹ Press Release, “FDIC Seeks in Excess of \$200 Million Against Credit Card Company and Two Banks for Deceptive Credit Card Marketing” (June 10, 2008).

² 15 U.S.C. § 45.

³ 15 U.S.C. § 57 (f).

⁴ 12 U.S.C. § 1818.

⁵ Financial Institution Letter from Michael J. Zamorski, Director of FDIC, *Guidance on Unfair or Deceptive Acts or Practices* (May 30, 2002).

⁶ *Id.*

⁷ Advisory Letter from Julie L. Williams, Chief Counsel of the OCC, *Guidance on Unfair or Deceptive Acts or Practices* (March 22, 2002).

⁸ *In the Matter of First National Bank of Marin, N.A., Las Vegas, Nevada (Bank)*, Consent Order, Office of the Comptroller of the Currency, December 3, 2001.

⁹ Statement of the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation, *Unfair or Deceptive Acts or Practices by State-Chartered Banks* (March 11, 2004).

¹⁰ *In the Matter of CompuCredit Corporation, Atlanta Georgia*, Consent Order, Federal Deposit Insurance Corporation (June 10, 2008).

¹¹ 12 U.S.C. § 1867(c).

¹² Third Party Relationships, OCC Bulletin 2001-47 (November 1, 2001).

¹³ Press Release, Federal Reserve Board, Federal Reserve Proposes Rules to Prohibit Unfair Practices Regarding Credit Cards and Overdraft Services (May 2, 2008).

¹⁴ Press Release, Request for comment on changes to Regulation Z to protect consumers from unfair or deceptive home mortgage lending and advertising practices (December 18, 2008).

¹⁵ H.R. 3526, 110th Cong. (2007); S. 2452, 110th Cong. (2007).

¹⁶ *Subprime and Predatory Lending: New Regulatory Guidance, Current Market Conditions, and Effects on Regulated Financial Institutions Before the Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit*, 110th Cong. (2007) (statement of Steven L. Antonakes, Massachusetts Commissioner of Banks).