



UNFAIR, DECEPTIVE, & ABUSIVE ACTS AND PRACTICES

Banking Law Institute
Minnesota State Bar Association

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Agenda

- **The UDAAP Challenge**
- **UDAAP Basics**
- **Cases**
- **Preventative Measures**

**THE
UDAAP CHALLENGE
IS
UNIQUE**

Recent Developments

- UDAP-based rulemaking (credit cards, overdrafts, HOEPA)
- Congressional pressure
- Financial crisis sparked by subprime
- Preemption eroding
- Dodd-Frank adds “abusive”
- Bureau of Consumer Financial Protection

Unprecedented Challenge

- At the political vortex
- Evolving overnight
- Limitless scope
- Permeating examinations
- Subjective standards
- Unreachable by today's compliance model

UDAAP creates danger zone
INSIDE
the legal line

This will transform bank
decision-making

Not Just a Large Bank Problem

“From 2008 through mid-2011, 43 percent of UDAP violations cited by the FDIC were for banks with total assets of \$250 million or less.”

Source: FDIC Chicago Region Regulatory Conference Call PowerPoint Presentation, June 16, 2011

UDAAP Basics

“Unfair”

- Causes “substantial” consumer injury
- Is not outweighed by consumer or competitive benefits, and
- Could not have been reasonably avoided

Substantial injury

- Can be substantial for few or slight for many
- Normally monetary, not speculative or emotional harm

Net harm

- Not outweighed by customer benefit
- Not outweighed by market benefit
- Better price or availability
- Costs to bank or society

Hard to avoid

- Interferes with decision-making
- Late disclosure
- Undue influence or coercion

“Deceptive”

- Representation, omission, or practice that:
 - Is likely to mislead a consumer acting reasonably
 - Is material in impacting consumer decisions and behavior

“Abusive”

- Materially interferes with consumer understanding, or
- Takes unreasonable advantage of consumer's:
 - Lack of understanding
 - Inability to self-protect
 - Reliance on the provider to act in the consumer's best interest

“Acts & Practices”

- All products
- All functions
- All relationships
- Non-product activities

“Special Sauce Effect”

- UDAAP surrounds and boosts other laws
- Escalates penalties and reputation risk

RECENT CASES

-
- Capital One Bank (USA) N.A. \$25 Million
 - Discover Bank 14 Million
 - American Express Centurion Bank 3.9 Million
 - JPMorgan Chase Bank N.A. 2 Million

UDAAP READINESS

Nine Dangerous Words:

“Show me where it says
I can’t do that.”

Traditional Model is 40 years old

It's designed to “check the boxes.”

It's not designed to deliver “fairness.”

Two-Part Strategy

- Be Holistic
- Be Proactive

It's risk management, ethics, and business

NOT “compliance”

Intent matters

Fairness Faults

- Non-fulfillment of “promise”/not “predictable”
- Complexity
- Opacity
- Late information
- Add-on products/Low value to customers
- Pricing/“Unconscionable” or “tricky” fees
- Harming vulnerable customers

1. Focus on “hot buttons”

- Overdraft fees
- Vendor-sold fees
- Ancillary products
- Debt cancellation/payment protection
- Identity theft protection
- Rewards programs
- Prepaid cards
- “Vulnerable” customers
- Third parties
- Misaligned incentives
- Servicing & collections

2. *Focus on fees*

- Above-average fee income
- Fees unrelated to costs
- Hard-to-explain charges
- Delayed charges
- “Fads” from industry and vendors

3. *Focus on communicating*

- Avoid trying to “disclose away” UDAAP problems
- Gear disclosures to customer need and capacity
 - (Pew research finds median 111-page checking disclosure)
- Make disclosures timely
- Make post-opening communications clear and helpful
- Explain well in *all* channels
- If something can't be explained, consider not doing it

4. Focus on vulnerable customers (especially for “abuse”)

- Not “Suitability” but....
- Abuse hits vulnerable customers
 - Elderly
 - Young
 - Minority
 - Limited education or English skill
 - Lower income
 - Financial distress
- Use *extra* care in terms, marketing, sales, and disclosures
- Do extra monitoring

5. *Evaluate complaints & surveys*

- Gather all complaints, written and oral
- Centralize analysis
- Find trends – technically legal, where customers say “unfair” or “I didn’t understand”
- These are UDAAP risks!
- Build UDAAP into other customer surveys

6. *Match offers to outcomes*

- Monitor whether most customers got the advertised terms
 - Avoid “bait and switch”
- Monitor customers who trigger penalty terms



7. Manage third parties

- Brokers and dealers
- Sales people
- Affiliated firms
- Sales finance arrangements
- Service vendors

8. *Align incentives*

- Avoid incenting oral deception
- Avoid incenting adverse pricing
- Include third parties!
- Compensate managers on compliance and ethics

9. *Address state law*

- Almost every state has UDAP
- Many have private right of action
- State regulators and AG's activated
- Federal preemption weakened

10. *Listen well*

- To customers
- To reviewers
- To employees

The “smell test”

- Will the bank do better if the customer does worse?
- Would you want your child or parent to have this product?

Risk Assessment

- By product life cycle
- By risk discipline

Assessing Risk By Product Life Cycle

- Approach is closer to the way the Bureau reviews products
- Allows a holistic view of the product lifecycle

Product Life Cycle

	Mortgage	Consumer Loan	Reward Checking	Overdraft Protection
Product Design				
Marketing				
Application /Solicitation				
Servicing				
Fees				

Across Products

Product Design	Mortgage	Consumer Loan	Reward Checking	Overdraft Protection
Marketing	Is there clarity and accuracy of the marketing message?			
Application /Solicitation				
Servicing				
Fees				

One Product Line

	Mortgage	Consumer Loan	Reward Checking	Overdraft Protection
Product Design	Analyze the impact of penalty fees on the profitability of the product(s) as well as the impact of penalty fees on the consumer?			
Marketing	Is there clarity and accuracy of the marketing message?			
Application /Solicitation	Are consumers underwritten based on ability to repay?			
Servicing	Review and evaluate policies and procedures governing pricing adjustments and modification of terms.			
Fees	Is there an equitable value exchange?			

Overdraft Risk Assessment

Overdraft		[Insert pr (add addition
		Culture
		Product Development / Int
10	How much does the bank collect a year in:	
11	Overdraft penalties?	
12	Servicing fees?	
13	Transaction fees?	
14	Other fees?	
15	How are these fees determined fair and reasonable?	
16	What percentage of total overdraft profitability is represented by each of the above categories?	
17	Is the percentage of total overdraft profitability within industry standards?	
		Marketing
4	Does opt-in information clearly explain which transactions are covered (one-time debit and ACH transactions)?	
4a	If the bank advertises for opt-in choices, are the advertisements clear, i.e., do they accurately portray the benefit from the Regulation E overdraft opt-in without exaggeration?	

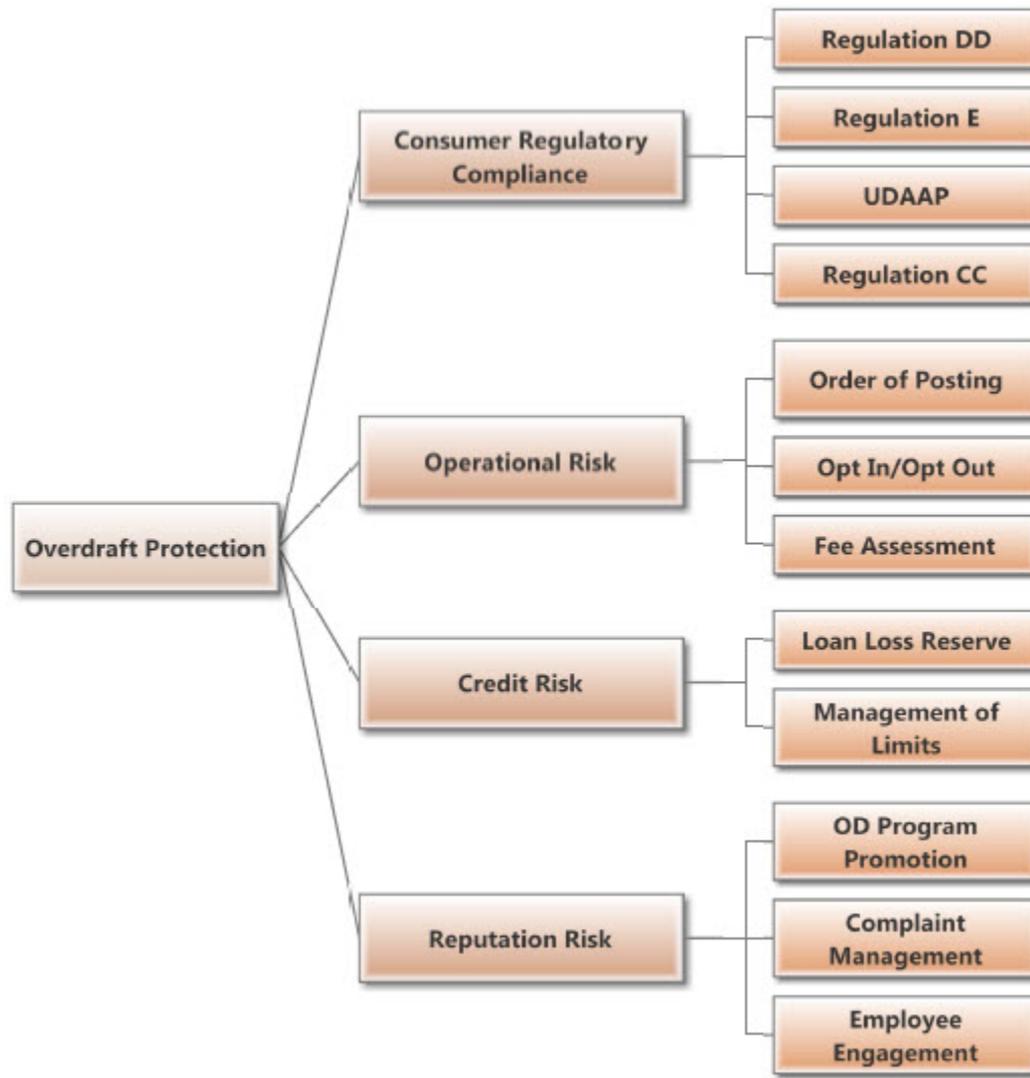
One Specific Product Element

	Mortgage	Consumer Loan	Reward Checking	Overdraft Protection
Product Design				
Marketing				
Application /Solicitation				
Servicing				
Fees				

Does Deposit Operations handle Overdraft Fees the way in which they are described in marketing materials?

Assessing Risk Across All Risk Disciplines

- UDAAP Risk exists in all risk disciplines
- Risks can fall into “cracks” between them
- Assessing UDAAP risks within each discipline can identify these risks





Reporting

- Report to right people
- Build metrics
- Catch attention

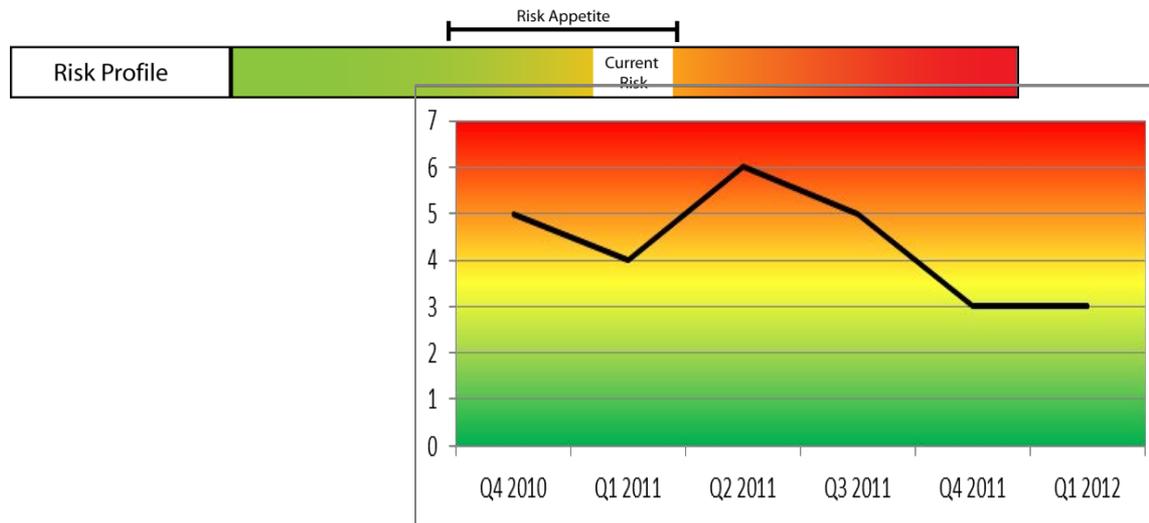
Reporting

UDAAP FEE RISK ASSESSMENT MODULE

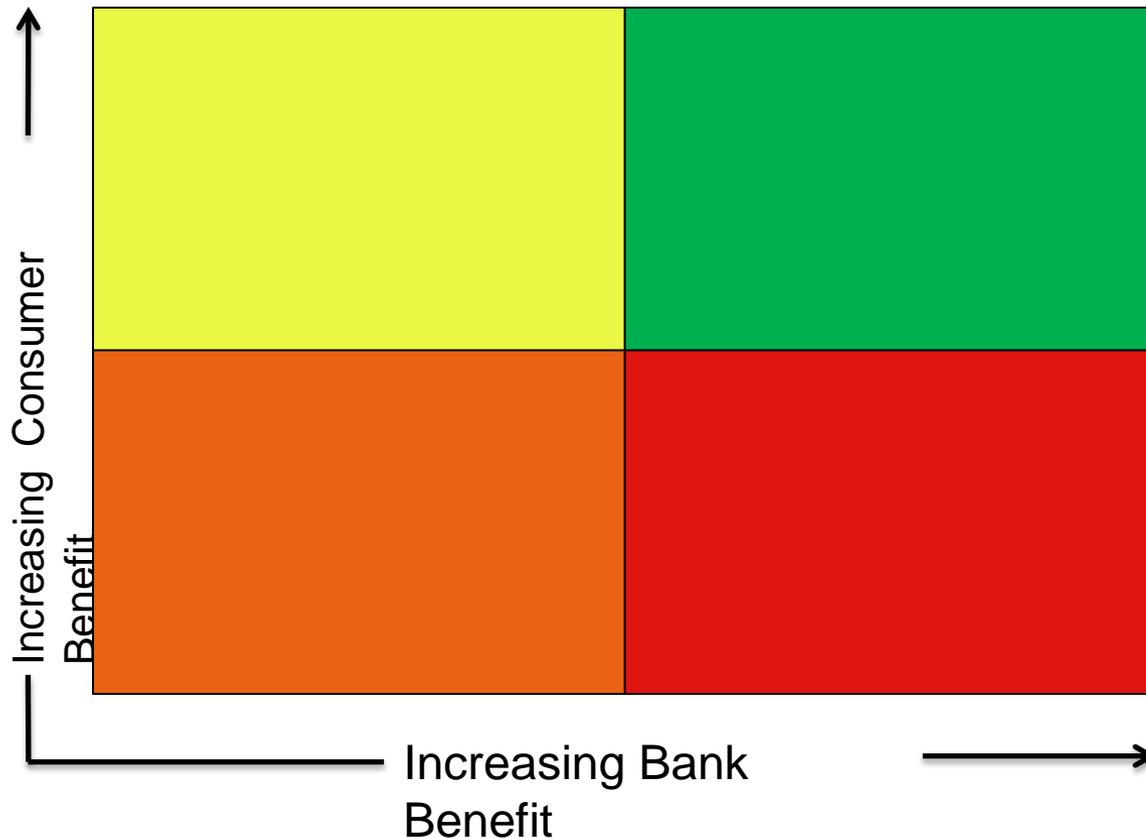
Sample completed

PRODUCT/SERVICE Name the product or service the customer is using when the fee is charged	FEE TYPE List each type of fee separately and describe specifically	PENALTY (Y/N) Is the fee a penalty for something the customer does or fails to do	SERVICE FEE (Y/N) Is the fee related to a service and not a penalty for a customer action or inaction	REASONABLY RELATED TO COST (Y/N/U) In order to be Yes, there must be documentation to support the cost of the service	COMPLEX TRANSACTION Is the transaction as "simple" or "single"	DISCLOSURES List the all terms of disclosure provided to the consumer; rate each one separately	DISCLOSURE EFFECTIVENESS Rate Effectiveness by "Effective" "Somewhat Effective" "Not Effective"; If there are complaints surrounding the disclosure, this cannot be "effective"	EASE OF EXPLANATION Rate by: Easy, Moderate, Difficult	SIZE OF FEE COMPARED TO PEERS (If in 90% of peers, risk is high)	VULNERABLE POPULATIONS Product Almost or primarily used by vulnerable Populations?	VENDOR INVOLVEMENT If vendor involves compensation based on consumer use this risk is "high"	COMPLAINTS Number of Complaints annual/probated to this fee/percentage of complaints to accounts	UDAAP/ FAIRNESS RISK RELATED TO THE FEE (High/Moderate/Low)
OVERDRAFT PROTECTION	48 Fee \$20/line that overdraws the account	Yes	Yes	Unknown	Simple OO related to paper checks are sent	Account Terms and Conditions; Reg DD the disclosure; OO related to time of occurrence; Statement	1. Terms and conditions: Not effective 2. Reg DD fee disclosure: Effective 3. Notice at time of OO: Effective 4. Statement: Moderate; Somewhat effective	Moderate	Fees a strong peers range from \$27.50 to \$35; this fee is in the middle range	No	Yes	125 complaints in previous calendar year; 4.25% of accounts	High
					Complex Doll pro- authorizations; also complex	Account Terms and Conditions; Reg DD the disclosure; OO related to time of occurrence; Statement	1. Terms and conditions: Not effective 2. Reg DD fee disclosure: Effective 3. Notice at time of OO: Effective 4. Statement: Moderate; Somewhat effective	Complex	Fees a strong peers range from \$27.50 to \$35; this fee is in the middle range	No	Yes	125 complaints in previous calendar year; 4.25% of accounts	High
REGULAR CHECKING MONTHLY SERVICE CHARGE	\$10/mo with for checking accounts with unlimited check writing and average balances less than \$1,000	No	Yes	Yes; bank has detailed documentation on each type of checking account with average transactional use per month; this information is updated semi-annually with actual customer account data and adjusted annually when all fees are adjusted	Simple	Disclosed as Regulated OO fee disclosure and on monthly statement	Effective	Easy	Fees range from \$7.50 to \$10; we are in the middle	No	No	27 complaints in last year; 14% of accounts	Low

Catch Attention



Treliant Product Fairness Map



Product Fairness Map Instructions

1. List the features of the potential product
2. Divide the features between the following categories:
 - Good for the Bank
 - Good for the Customer
 - Good for Both
 - Bad for the Bank
 - Bad for the Customer
 - Bad for Both
3. For each category, determine the magnitude of each feature
4. Plot each one on the Fairness Map
5. Determine where there is a cluster-these are the most dominant characteristics
6. Features that are bad for the customer and the Bank should be eliminated from the product
7. Consider whether negative features can be altered to improve their benefits for both (the goal should be that the product should be good for both the customer and the bank)
8. Carefully scrutinize any product in the “good for the Bank; bad for the Customer” category. This is a UDAAP red flag



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