FROM UDAP TO UDAAP TO ??

A common sense look at new standard

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UDAP has been a sleeper. But UDAAP is a wakeup call.

Looking back on UDAP

Long part of the Federal Trade Commission Act, UDAP has prohibited trade practices that are unfair or deceptive. FTC has jurisdiction for enforcing UDAP over most aspects of commercial activity. However, with respect to banks, thrifts, and credit unions, responsibility for enforcement lies with the prudential regulators-the Federal Reserve Board, FDIC, the Comptroller's Office, and the National Credit Union Administration.

Defining what unfair or deceptive means has been the purview of the Federal Trade Commission. The FTC Act directed the financial regulatory agencies to apply those standards to actions undertaken by banks, thrifts, and credit unions.

For a long time, in the banking world, little happened. FTC developed several rules under UDAP. One related to the "holder in due course" status of purchasers of commercial paper; one related to pyramiding late charges; and the third related to unfair contract terms. The latter two rules were re-issued by the Fed and NCUA because they specifically relate to credit practices. The holder in due course rule only applied to sellers of goods or services who also provided financing.

Then along came some credit card marketing practices that simply could not be ignored.

Providian became the poster child for UDAP. OCC joined in the case against Providian and suddenly, consideration and enforcement of UDAP became popular.

Looking forward on UDAAP

In the Dodd-Frank Act, "abusive" was added to the list of prohibited trade practices. The FTC Act now prohibits unfair, deceptive, or abusive trade practices. In the same act, the Consumer Financial Protection Bureau was created--with authority to take enforcement actions for practices that violate the UDAAP standard.

CFPB, now up and running, has made it clear that UDAAP enforcement is an important arrow in their quiver. In fact, it might even be the bow--the cross-bow.

CFPB's early actions demonstrate that UDAAP will play a large and active role in the Bureau's efforts. Consumers are being encouraged to complain to CFPB about any situations where they feel unfairly treated. CFPB helps consumers complain by providing hints and topic areas on its website. The consumer complaint format provided on the website invites consumers to think about whether discrimination or UDAAP may have been involved in their situation.

Questions related to potential UDAAP practices permeate the recently-published examination procedures. Rather than sitting in isolation, UDAAP is embedded throughout the procedures. UDAAP is used as the foundation of the examination approach. Everything will be evaluated in the context of fairness to the customer, rather than simply technical compliance.

Inevitable has finally happened

What does this mean? Arguably, the concept of UDAP, now UDAAP, is the underlying theme of compliance. For example, Truth in Lending requires disclosure of the cost and terms of credit. Withholding this information would be unfair or deceptive. The Equal Credit Opportunity Act bars discrimination on a prohibited basis. Refusing credit or increasing the rate because of an applicant's race would be unfair. Holding deposits made by check for unreasonable periods of time without telling the customer the rules is unfair.

In the compliance world, we tend to focus on compliance with what is squarely in front of us. Compliance programs are designed to carry out everything that regulations require. This means checking off all the items for compliance before going to loan closing. It means setting up operating systems to do accurate calculations and complete disclosures.

In all this focus on compliance with existing laws, we don't always take a step back and consider the fairness of the products or services. It may be good for the bottom line, but is it good for the customer? Does the customer know everything they should know before making a decision?

UDAAP enforcement is something that we should have seen coming. There was plenty of noise about overdraft protection programs that should have warned banks about how the product was coming to be viewed. Complaints about lengthy holds resulted directly in legislation regulating holds. Both of these situations could have been anticipated and additional regulation averted if the industry had self-examined using UDAAP-style standards.

UDAAP is law. Now what?

So, given this UDAAP emphasis, what should banks do?

First, focus on marketing.

Marketing can often be "out there," exposing some banks to risk from the UDAAP police. Make sure marketing materials are reviewed under UDAAP standards before they are put before the public in any form.

Second, make sure that UDAAP issues are considered in all new product development and in product changes.

For example, if the bank decides to impose a monthly fee on checking accounts, consider how your customers will react to the fee. Also look for any promises made to customers previously. There may be a "free checking for life" promise lurking out there.

Third, pay close attention to customer complaints.

In fact, pay close attention to any customer feedback. This is your early warning system.

Finally, remember the old saying about the customer.

The customer may not always be right, but treat them as though they are.

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About Lucy Griffin

"Lucy and Nancy's Common Sense Compliance" is blogged by both Lucy Griffin and Nancy Derr-Castiglione, both longtime ABA Banking Journal contributing editors on compliance.

- Lucy, a Certified Regulatory Compliance Manager, has over 30 years experience in compliance. She began as a regulator, including stints with the Federal Reserve Board, the Federal Trade Commission, and the Federal Home Loan Bank Board. For many years she managed the ABA Compliance Division. Since 1993 she has served as a compliance consultant as president of Compliance Resources, Inc., Reston, Va. She is also editor of Compliance Action newsletter and senior advisor with Paragon Compliance Group, a compliance training firm.

In addition to serving as a Contributing Editor of ABA Banking Journal, Lucy serves on the faculty of ABA's National Compliance Schools board. For more than a decade she developed and administered the case study at ABA's National Graduate School of Compliance Management. She can be reached at lucygriffin@earthlink.net

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