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ISSUE BRIEF

Unfair, Deceptive, or Abusive Acts or Practices (UDAAP)

NAFCU

TABLE OF CONTENTS

UNFAIR, DECEPTIVE, OR ABUSIVE ACTS OR PRACTICES (UDAAP)

In response to the Great Recession, Congress enacted the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) in 2010. Under the Dodd-Frank Act, it is unlawful for a provider of consumer financial products or services to engage in any unfair, deceptive, or abusive acts or practices (UDAAP). *See* 12 U.S.C. §§ 5531(a); 5536(a)(1). Through the Dodd-Frank Act, Congress granted the Consumer Financial Protection Bureau (CFPB) the ability to define "unfair, deceptive, or abusive acts or practices" in any transaction with a consumer for a consumer financial product or service. The CFPB was granted broad and unprecedented rulemaking and enforcement authority regarding unfair, deceptive, and abusive acts or practices and prohibits depository institutions and nonbanks from engaging in those practices. Therefore, all entities that fall under the CFPB's purview, including credit unions, need to closely monitor the Bureau's use of its UDAAP authority.

However, credit unions with $10 billion or less in assets will be examined and supervised for compliance with federal consumer financial laws by the National Credit Union Administration (NCUA) or their state regulator. *See* 12 U.S.C. 5516. Although the CFPB does not have direct enforcement or UDAAP authority over credit unions with $10 billion or less in assets, the Bureau will notify and coordinate with the NCUA if it suspects a violation of federal consumer financial laws. *See* 12 U.S.C. 5516 (d). The NCUA has a Federal Consumer Financial Protection Guide available on its website to help credit unions within this threshold comply with most federal consumer protection laws. As such, this issue brief is primarily intended to assist with UDAAP compliance for larger credit unions directly subject to the CFPB's enforcement authority by explaining what makes an act or practice unfair, deceptive, or abusive.

The Dodd-Frank Act expanded the scope of UDAAP from "unfair or deceptive" to "unfair, deceptive, or abusive." In so doing, it expanded the CFPB's authority to identify acts or practices as "abusive" to consumers even though those acts or practices may not have met the test of being either "unfair or deceptive" in the past. The Bureau has used its UDAAP authority to target hot button issues such as credit card add-on products, credit card advertising, debt collection, credit reporting and monitoring, auto lending, and mortgage servicing.

In creating the new consumer protection category, Congress did not provide guidance to the Bureau as to what an abusive act or practice is. Additionally, Congress did not require the CFPB to issue implementing regulations through notice and comment rulemaking. Since the passage of the Dodd-Frank Act, the UDAAP statute has created significant compliance challenges for financial institutions. Moreover, financial institutions paid billions to train employees and develop UDAAP compliance programs.

The abusiveness prong of UDAAP has been a particular source of uncertainty since the passage of the Dodd-Frank Act. Because the Dodd-Frank Act was the first federal law to broadly prohibit *abusive* acts or practices, there is little, if any, basis for how to approach and apply the standards. Of particular concern is the absence of a body of jurisprudence addressing the parameters of abusive conduct and the desired legal response to such enforcement actions. The prevailing uncertainty has created challenges for covered persons in complying with UDAAP and may impede the lawful use of financial products or services that are beneficial to consumers.

SETTING THE STAGE: THE POLITICAL LANDSCAPE AND THE NEED FOR CLARITY

Under President Joe Biden, the CFPB has already started taking a different approach to supervision and regulation. During the Trump administration, critics complained that the CFPB had become toothless, initiating only 77 enforcement actions compared to 235 during former President Obama's first term. Now, under Director Rohit Chopra, the CFPB is poised to increase the rate of its enforcement actions in the interest of consumer protection. Although most banking laws are accompanied with detailed regulations, UDAAP has no implementing regulations. A brief review of the Bureau's historical approach to UDAAP highlights the political divide surrounding this authority.

Former CFPB Director Richard Cordray, nominated by President Obama, defined and expanded the Bureau's UDAAP authority through enforcement actions, consent orders, and occasional supervisory guidance. Keeping UDAAP over-broad, flexible, and vague makes compliance a challenge for depository institutions. In 2017, President Trump appointed Mick Mulvaney as Acting Director of the Bureau and, in stark contrast to Cordray, Mulvaney chose not to regulate by enforcement as strictly but rather to scale back its enforcement actions regarding UDAAP. When Director Kathy Kraninger was confirmed in 2018, she chose to focus CFPB's attention on preventative measures to discourage UDAAP among depository and nonbank institutions. In January 2020, then-Director Kraninger announced that the Bureau would clarify the murky "abusiveness" standard in UDAAP with the release of a Policy Statement.

The 2020 Policy Statement set forth a three-part set of principles stating that the Bureau would:

1. Focus on citing or challenging conduct as abusive in supervision and enforcement matters only when the harm to consumers outweighs the benefit;
2. Generally avoiding "dual pleading" of abusiveness and unfairness or deceptive violations arising from all or nearly all the same facts; and alleging "stand alone" abusiveness violations that demonstrate clearly the nexus between cited facts and the Bureau's legal analysis; and
3. Seek monetary relief for abusiveness only when there has been a lack of a good-faith effort to comply with the law, except that the Bureau will continue to seek restitution for injured consumers regardless of a good-faith consideration.

In March 2021, under former Acting Director Uejio, the Bureau rescinded this Policy Statement, claiming it was "inconsistent with the Bureau's duty to enforce Congress's standard" and that its rescission will "better serve the CFPB's objective to protect consumers from abusive practices." Now, credit unions are back to square one with the CFPB intent on returning to the "regulation by enforcement" approach seen under former Director Richard Cordray. NAFCU has consistently highlighted UDAAP as an area where the CFPB could further clarify its expectations for credit unions and the specific factual basis for violations.

Under Director Chopra, certain guidance has been issued that has the potential to massively expand the scope of prohibited acts and practices. On March 16, 2022, the Bureau published a revised examination procedure guide for UDAAP that indicated the agency is targeting discrimination as an "unfair" practice in connection with all financial products and services and not just credit products. This is a serious shift in the CFPB's stance on UDAAP that is likely to expand the reach of the Bureau's anti-discrimination enforcement beyond the scope of the *Equal Credit Opportunity Act* (ECOA). Under ECOA, creditors are prohibited from discriminating against a consumer on the basis of race, color, religion, national origin, sex, marital status, or age. Discrimination does not need to be intentional in order to constitute a violation under ECOA.

While the Bureau has yet to explicitly discuss what types of discrimination are covered under the CFPB's new stance, it appears that the Bureau may begin engaging in disparate impact enforcements. Disparate impact occurs when a neutral credit union policy results in discrimination against members in a protected class or on a prohibited basis that results in fewer services or access to information than other members. Credit unions may wish to begin looking at their policies, practices, and procedures for non-credit financial products and services to assess their UDAAP risk under this recent guidance.

EXPLAINING UNFAIR ACTS OR PRACTICES

According to the CFPB's Supervision and Examination Manual and recent consent orders, an act or practice is unfair when it meets the following three-part test:

1. It causes or is likely to cause substantial injury to consumers;
2. The injury is not reasonably avoidable by consumers; and
3. The injury is not outweighed by countervailing benefits to consumers or to competition.

12 U.S.C. § 5531(c)(1)(a)-(b).

I. The act or practice must cause or be likely to cause substantial injury to consumers.

The key phrase is "substantial injury." In almost all cases, substantial injury will mean monetary harm (fees or costs paid by the consumer). However, the term "substantial" does not mean a large sum of money. The CFPB will likely find substantial injury when a financial institution charges a small fee to a large group of consumers. From the Bureau's perspective, a small dollar amount of harm to a large number of people is the same as a massive dollar amount of harm to one person.

Actual substantial injury is *not* required. A "significant risk of concrete harm" is enough to meet the substantial injury prong. Moreover, substantial injury can occur without monetary harm. Although trivial and merely speculative injuries will not typically rise to the level of substantial injury, in certain circumstances emotional harm may amount to or contribute to substantial injury. In a recent CFPB Consent Order, Cash Tyme (February 5, 2019), the Bureau highlighted several debt collection harassment acts and practices that amounted to or could contribute to substantial injury: (1) requiring consumers to list their home and cell phone numbers and telephone numbers for their employer, supervisor, and four other personal references; (2) routinely calling and disclosing the existence of consumer's debts to non-liable third parties listed by the consumer; (3) continuing to call consumers frequently at work and leaving messages for the consumers and their personal references; and (4) calling without the expectation or intention that the direct consumer of the product would be reached. In the 2022 revision to the examination procedure guide, discrimination that denies access to products or services, causes a consumer to forgo monetary benefits, or causes an emotional impact or dignitary harm may be considered to cause or contribute to substantial injury.

II. Consumers must not be reasonably able to avoid the substantial injury.

The second prong hinges upon whether an act or practice hinders a consumer's rational and reasonable decision-making process. The key question is not whether the consumer *could* have made a better choice; rather it is whether all *material information* is available to the consumer prior to any decision. In other words, if information has been hidden, omitted, withheld, or presented inaccurately, this act may hinder the consumer's decision-making process and may ultimately prevent the customer from avoiding substantial injury.

The CFPB engages in a fact-specific inquiry to determine if a consumer can *reasonably* avoid substantial injury. Without implementing regulations, credit unions find it challenging to determine reasonableness. Fortunately, the CFPB's consent orders and recent guidance provide some clarification of what the Bureau considers unreasonable. First, substantial injury is not reasonably avoidable by consumers when an act or practice interferes with or hinders a consumer's ability to make informed decisions or take action to avoid that injury. *See*, CFPB Supervisory Highlights - Winter 2019, pp. 4, 7. Specifically, the CFPB references instances where financial institutions switched balance-calculation methods, thereby causing consumers to incur excess overdraft fees. In the 2022 revision to the examination procedure guide, the Bureau states that "[c]onsumers cannot reasonably avoid discrimination," indicating that, if the first prong of the unfairness analysis is met with regard to discrimination, the second prong will automatically be met.

Second, substantial injury caused by transactions that occur without a consumer's knowledge or consent is not reasonably avoidable. According to its Consent Order against Military Assistance Company LLC, a subsidiary of Fort Knox National Company (April 20, 2015), service members entered into an agreement with the company to pay creditors of the service members. Once a service member's creditors were fully paid, Military Assistance Company LLC continued to receive funds from the service members and began charging service members a fee for keeping funds in the service member's account. The issue was whether Military Assistance Company LLC properly disclosed the fee when the service member entered into the agreement. The Bureau found that periodic notices sent to service members alerting them to fees was inadequate. Regardless of the company's actions, the CFPB determined reasonableness is based upon the consumer's knowledge and consent.

Third, substantial injury is not reasonably avoidable when an institution charges a consumer for a service it does not provide. In its Consent Order against U.S. Bank National Association (U.S. Bank) (Sept. 25, 2014), the CFPB alleged the bank signed customers up for identity protection and credit monitoring products. To obtain a customer's credit information, U.S. Bank required written authorization. However, in many cases, a customer never completed a written authorization. Nevertheless, U.S. Bank continued to bill customers for identity protection and credit monitoring products it did not provide. The Bureau concluded that the customers could not have reasonably avoided this service because it was unbeknownst to the customers that it existed nor was written authorization given to receive the service.

Lastly, substantial injuries that can only be avoided by spending large amounts of money or other significant resources also may not be reasonably avoidable. For instance, if a consumer could only avoid substantial injury by hiring an expert, such an act would be considered unreasonable because hiring an expert to review individual products or services is impractical for individual consumers. *See*, CFPB Supervision and Examination Manual, UDAAP 2.

III. Substantial injury must not be outweighed by countervailing benefits to consumers or competition.

The last prong requires a substantial injury resulting from an unfair act or practice to be greater than "any offsetting consumer or competitive benefits that also are produced by the act or practice." *See*, CFPB Supervision and Examination Manual, UDAAP 3. When outweighed by any offsetting consumer or competitive benefits, no substantial injury will be found. Offsetting consumer or competitive benefits include lowering prices, ensuring competition by offering more products or services, and determining the total cost to prevent substantial injury.

Without implementing regulations, credit unions must develop a compliance program based on the statute and how it is enforced by the CFPB. A UDAAP compliance program must frequently evaluate new enforcement actions, consent orders, and CFPB guidance. When evaluating consent orders to develop a UDAAP compliance program, it is notable that neither the allegations in enforcement actions nor recitations in consent orders are binding, except as between the parties involved. Consent orders are merely agreements between a regulator and a specific institution and cannot be relied upon in a court. Nevertheless, without implementing regulations, the only way to learn what is an unfair, deceptive, or abusive act or practice is by assessing the mistakes of others. CFPB consent orders are publicly posted on its Enforcement Actions webpage.

EXPLAINING DECEPTIVE ACTS OR PRACTICES

According to the CFPB's Supervision and Examination Manual and at least one appellate court's legal interpretation, an act or practice is deceptive when it meets the following three-part test:

1. The representation, omission, act, or practice misleads or is likely to mislead the consumer;
2. The consumer's interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and
3. The misleading representation, omission, act, or practice is material. See, CFPB v. Chance Gordon et al., 819 F.3d 1179 (9th Cir. 2016).

Note that intent is not a requirement. Common mistakes may be deceptive under UDAAP, even if the credit union did not intend to deceive its members. For a representation, omission, act, or practice (hereinafter collectively referred to as representations) to be deceptive, all three parts of the test must be present.

I. There must be a representation that misleads or is likely to mislead the consumer.

Determinations of whether a representation is likely to mislead a consumer are not made in isolation and all factors surrounding the representation are considered. Actual deception is not required for a representation to be deemed deceptive for enforcement purposes. If it is likely the representation will mislead the consumer, the representation may be deceptive. According to the CFPB's Supervision and Examination Manual, the following five representations may be considered deceptive:

› Making misleading cost or price claims
› Offering to provide a product or service that is not in fact available
› Using bait-and-switch techniques
› Omitting material limitations or conditions from an offer
› Failing to provide the promised services

Another helpful example is found in the Manufacturers and Traders Trust Company (M&T) Consent Order. In the consent order, the CFPB cited M&T for deceptively advertising free checking accounts. The CFPB found that M&T advertised checking accounts to consumers with promises of "no strings attached" free checking, without disclosing key eligibility requirements or the requirement that customers had to maintain a minimum level of account activity. Some of M&T's advertisements stated:

› "Have you raised the green flag for free checking from M&T Bank? There's no minimum balance requirement and no monthly service charge;"
› "Untangle yourself from monthly service fees. Get a free checking account at M&T. No strings attached;"
› "M&T Totally Free Checking No minimum Balance. No monthly service charge."

Consumers that failed to meet undisclosed account activity requirements were automatically converted to checking accounts that did impose monthly fees. As a result, the CFPB found that M&T's representations were deceptive because the bank's advertising and marketing failed to disclose the minimum activity requirement necessary to maintain free checking.

All of the advertisements led a consumer to believe that the advertised checking account did not have any additional requirements. Although not discussed in the consent order, arguably all five of the deceptive representations in the CFPB's exam manual are present in these advertisements. For instance, the use of word "no strings attached" implies there are no requirements to maintain the account. Second, M&T offered consumers a product or service that was not available. Third, the bank engaged in a bait-and-switch technique by promising a "no strings attached" checking account but signed consumers up for a checking account with strings. Fourth, the bank omitted material limitations or conditions of the checking account from the advertisement (*e.g.,* minimum balance requirements). Lastly, M&T failed to provide the promised services by not giving its consumers a free checking account.

The M&T consent order is useful guidance regarding advertising checking accounts, but advertisements for a variety of products and services could be interpreted to contain one of the five misrepresentations identified by the CFPB. To help financial institutions evaluate whether a representation is likely to mislead consumers, the CFPB has adopted the "four P's" test:

- Prominent: whether the disclosure is prominent enough for a consumer to notice.
- Presented: whether the information is presented in a clear and easy to understand format.
- Placement: how the information is placed within the advertisement.
- Proximity: how distant the information is from the claims in the advertisement that it qualifies. *See*, CFPB's Supervision and Examination Manual, UDAAP 5-6.

The "four P's" test is not a safe harbor — the CFPB does not state that ensuring any one, or all, of the "four P's" will prevent a consumer from being misled. The test merely allows a credit union to evaluate whether a representation is likely to mislead.

If a misleading representation is made, the credit union will likely want to correct the statement to avoid a UDAAP violation. The examination manual states that written disclosures may be insufficient to correct a misleading statement. Likewise, oral or fine print disclosures or contract disclosures may also be insufficient. Unfortunately, the CFPB has not provided clear guidance on how financial institutions can properly remedy a misleading statement. Without any additional guidance from the CFPB, it appears the only way to avoid a UDAAP violation is to not make a misleading statement at all.

II. The consumer's interpretation of the representation is reasonable under the circumstances.

Determining if a consumer's interpretation was or would be reasonable requires identifying the "target audience" and ascertaining whether the interpretation was reasonable from the perspective of that "target audience." The "target audience" is the specific group the credit union is soliciting. A typical "target audience" could be older Americans, veterans, college students, or financially distressed consumers. When a credit union's representation could convey an untrue or false meaning to a reasonable member of the "target audience," the representation is deceptive.

A CFPB Consent Order against NewDay Financial, LLC (NewDay) (February 10, 2015) articulated an example of a deceptive representation to a "targeted audience." The Bureau took action against NewDay in connection with its marketing of lending products. Under a marketing agreement with a non-profit membership organization serving veterans, NewDay was permitted to send direct advertisements under the name of the organization, thus promoting the relationship between the two companies and recommending the use of NewDay's mortgage products, in exchange for the payment of certain "lead generation fees." NewDay's marketing materials listed NewDay as the exclusive lender and "lender-of-choice" of the organization based on NewDay's "high standards for service and the excellent value of their programs." One advertisement also stated the organization endorsed NewDay after spending significant time with NewDay's management and loan professionals. However, the organization's members were not made aware of the agreement and payments between it and NewDay; the information was not made public. Based on these facts, the CFPB found that NewDay's failure to disclose its arrangements with the veteran's organization would likely be misleading to reasonable consumers.

A deceptive representation does not need to mislead all consumers. A credit union may want to determine if a significant minority could be misled by the representation. If so, the credit union will want to take steps to ensure the representation is made accurate. Ensuring representations made by a credit union are factually supported will minimize the risk of deceiving consumers. *See*, CFPB's Supervision and Examination Manual, UDAAP 6.

III. The misleading representation is material.

Material information will likely affect a consumer's choice or conduct. The CFPB lists certain categories of information that are presumed to be material:

> "Information about the central characteristics of a product or service—such as costs, benefits, or restrictions on the use or availability—is presumed to be material. Express claims made with respect to a financial product or service are presumed material. Implied claims are presumed to be material when evidence shows that the institution intended to make the claim (even though intent to deceive is not necessary for deception to exist).

> "Claims made with knowledge that they are false are presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to evaluate the product or service." *See,* CFPB's Supervision and Examination Manual, UDAAP 6.

For example, in the Cash Express Consent Order (October 24, 2018), the Bureau found that including a provision in a loan that states, "We may report information about your account to credit Bureaus. Late payments, missed payments, or other defaults on your account may be reflected in your credit report," is a material misrepresentation. The Bureau ascertained that this misrepresentation was material in that such reporting can negatively harm a consumer's ability to obtain credit in the future and thus may cause consumers to pay debts solely to avoid negative credit reporting.

The CFPB has consistently utilized its UDAAP authority against financial institutions for making material representations that are explicitly false. One example is the CFPB's consent order with Dealers' Financial Services, LLC (Dealer) (June 25, 2013). According to the consent order, Dealers' misrepresented that an add-on vehicle service contract would add "just a few dollars to your monthly payment" or that a GAP insurance product would add "just a few pennies a day to your monthly payment." In reality, the costs of the add-on products were over $40 and $12.55, respectively. The Bureau found this misrepresentation of the cost material, as a consumer may not have purchased the add-on products if they knew their true cost.

Omission of a material statement is also deceptive. For instance, in CFPB Bulletin 2017-021, the Bureau discovered that various providers of financial products and services provide consumers with payment options that include making payments over the phone. Oftentimes if phone payment options are available, the entity would not disclose that there are relevant transaction fees that apply to take advantage of the phone payment method. To omit that fees apply to consumers wishing to take advantage of some payment method may push some customers into materially higher-cost options. Without information that there are applicable fees to certain payment methods, consumers may not be able to reasonably avoid racking up fees unbeknownst to them.

Information may be material—even if it is not presumed to be material—if there is evidence that the information is likely to be considered important by consumers. *See*, CFPB's Supervision and Examination Manual, UDAAP 6-7. One method to determine if information is important is to remove that piece of information and determine whether the consumer's decision may be affected. If so, the information is likely material.

EXPLAINING ABUSIVE ACTS OR PRACTICES

To date, no depository institution has been the subject of an enforcement action for abusive acts or practices. Nevertheless, depository institutions, including credit unions, wishing to comply with UDAAP may consider taking affirmative steps to comply with the original intent of the UDAAP statute at the same time as understanding how the CFPB will enforce the law. The Dodd-Frank Act defines an act or practice as "abusive" if it:

› Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
› Takes unreasonable advantage of—
  - 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 selecting 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.

12 U.S.C. 5531(d)(1)-(2)(c).

I. The act or practice materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service.

Of the sixteen enforcement actions regarding abusiveness, only two of them involve allegations that the institution materially interfered with the consumer's ability to understand a term or condition. These enforcement actions help shed some light on what the acts or practices the CFPB believes rise to the level of "materially interfering" with the consumers ability to understand a term or condition.

The first enforcement action, *CFPB v. NDG Financial Corp.* (NDG), involved a lender that offered payday loans over the internet to consumers throughout the United States. The loans were short term and ranged from $100 to $1,500, with finance charges of about $20 per $100 borrowed. In making these loans, the lender failed to comply with state licensing and usury laws and therefore the lender lacked legal authority to collect the loans. Upon default, the lender attempted to collect on the loans. The complaint alleged that the lender's efforts to collect on these loans were abusive because they "materially interfered with consumers' ability to understand that they were not under [a] legal obligation to repay the loan amounts that were void under state law."

In the second enforcement action, *CFPB v. Pension Funding, LLC et al.* (Pension Funding), the CFPB alleged that the creditor obscured the true nature of the credit transaction by "denying that their product was a loan and instead referring to it as a pension advance, pension buyout, pension lump sum, money purchase pension plan, purchase of a cash stream of payments, or purchase." The Bureau claimed that by failing to disclose or by misrepresenting aspects of the loan, Pension Funding materially interfered with the consumers' ability to understand important terms of the loan.

In both of these enforcement actions, the CFPB claimed that the creditors interfered with the consumers' ability to understand a material term or condition. The Bureau took the position that a lender is required to ensure that the customer is fully aware of their legal rights and options, even if that option would be adverse to the lender. Aside from properly advising or disclosing certain aspects of a transaction, the CFPB failed to provide guidance as to how a lender may ensure all material terms are properly disclosed to avoid taking unreasonable advantage of a consumer.

II. The act or practice takes unreasonable advantage of…

The following three categories of conduct focus on whether the abusive act or practice takes unreasonable advantage of a consumer. Although the CFPB has declined to formally define the term "unreasonable advantage," this requirement necessitates that the Bureau articulate that the institution receives some benefit from the abusive conduct. In recent litigation, the Bureau construes the use of "unreasonable advantage" to be that of the plain meaning of the language, given the ordinary meanings of the words. Enforcement actions state that an unreasonable benefit typically involves the institution receiving a material advantage over the consumer, thereby placing the defendant institution in a better position to collect funds from the consumer. The type of advantage ranges from inserting clauses into contracts to omitting information that would enable a consumer to stop an abusive practice. Until formally defined, the CFPB can interpret this term to allege almost any act or practice takes unreasonable advantage of the three remaining theories below.

A. The lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service.

Central to this category of abusive acts or practices is what constitutes a lack of understanding. Recent enforcement actions suggest the CFPB will allege a lack of understanding when an institution deceives a consumer about a material term. For example, in *CFPB v. D & D Marketing, Inc.*, a company providing sales leads to lenders falsely suggested it would help consumers find the best interest rates for loans and that it would review consumers' applications to match them with appropriate lenders. Contrary to such representations, consumers were steered to lenders that charged higher interest rates, violated state usury laws, and offered contracts providing for the application of tribal law to the contract and the use of tribal dispute-resolution processes.

A lack of understanding is not limited to misrepresentations of terms or facts. As explained in *In the Matter of Fort Knox Nat'l Co.* (Fort Knox), the CFPB also alleges abuse when an institution omits information that would help a consumer understand material risks, costs, or conditions. Fort Knox engaged in the payment processing business by assisting service members with their allotments. At issue was whether Fort Knox adequately disclosed various fees charged to service members when excess money accumulated in a service member's account. According to the CFPB, "[s]ervice members may not have understood that they would be charged Residual Balance Fees if they accrued a Residual Balance because Respondents did not adequately disclose specific fees and did not notify service members when they had incurred specific fees." The CFPB stated that a consumer will have a lack understanding of a material term when it is omitted from disclosures.

The Bureau alleges that an institution is taking unreasonable advantage of a lack of understanding on the part of the consumer when it finds an institution is misrepresenting or omitting terms or conditions that relate to material risks, costs, or conditions of a product or service. The Bureau does not look at any particular type of risk, cost, or condition; rather, it finds abuse when an important term is not properly disclosed. Thus, the CFPB will likely find abuse when an institution fails to adequately inform consumers of terms or conditions associated with a product or service or exploits a consumer's lack of understanding that results in harm to the consumer.

B. *The inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service.*

While the Bureau alleges this type of conduct more frequently, it is not because the industry is more apt to commit these types of abusive acts or practices. Rather, the second category is alleged more often because the CFPB often argues one practice is an abusive act or practice under multiple theories. For example, in Fort Knox the Bureau also alleged the conduct took unreasonable advantage of consumers' inability to protect their interests because the fees were not disclosed in the account agreement and the fees did not appear on the service members' periodic statements.

Although categories two and three are similar, they are separate groups of abusive acts or practices. One distinguishing feature is that practices that take unreasonable advantage of a consumer's inability to protect his or her interests may involve disclosures that may comply with laws such as Regulation Z, but for one reason or another, the CFPB believes that the terms themselves are oppressive. For example, in *In the Matter of Freedom Stores, Inc.* (Freedom), the CFPB alleged abusive conduct in the filing of debt collection lawsuits in Norfolk, Virginia. Freedom's practice of filing collection suits in the Virginia courts was based on a forum selection clause contained in its consumer contracts. In its enforcement action, the Bureau noted that most borrowers had little opportunity to review the underlying contract before signing and were unaware of the existence of the forum selection clause.

Moreover, the CFPB alleged that even if the consumers were aware that the contract contained a forum selection clause, consumers did not have an opportunity to bargain for its removal, as the clause was non-negotiable. The Bureau alleged that Freedom selected the forum because it "was almost certain to produce default judgements and lead to garnishments against consumers," as consumers lived and signed these contracts while "far away" from Norfolk, Virginia. Thus, the CFPB viewed Freedom's actions as oppressive to consumers and thereby abusive.

Another distinguishing feature is that the CFPB alleges abuse when institutions use aggressive or predatory tactics against consumers. The Bureau has alleged such tactics render the consumer unable to protect their own interests when using a financial product. For example, in *In the Matter of Security National Automotive Acceptance Company, LLC.* (SNAAC), an automobile lending company threatened to contact, and did contact, delinquent service members' commanding officers to inform them that the service members were in violation of the Military Code regulations due to non-payment of debt. In a similar case, the Bureau took enforcement action against *ACE Cash*, where it alleged that debt collectors leveraged an artificial sense of urgency to induce delinquent borrowers with a demonstrated inability to repay their existing loan to take out a new loan.

In reviewing enforcement actions that allege an act or practice takes unreasonable advantage of the inability of the consumer to protect his or her interests, the CFPB tends to advance two theories. It is possible the Bureau could find abuse in other acts or practices; however, if a contract clause is oppressive or the institution engages in aggressive or predatory tactics, the CFPB will likely allege abuse in a potential UDAAP enforcement action.

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

While not as frequently alleged as conduct falling within categories one and two, the CFPB has consistently found it abusive when consumers reasonably rely to their detriment on representations made by institutions. Under this theory, the CFPB must allege that an average consumer relied on a representation that resulted in the consumer being harmed.

Generally, the CFPB finds an act or practice takes unreasonable advantage of a consumer's reasonable reliance when a group relies on an institution's representations and the institution fails to provide the represented benefit. For example, in *CFPB v. ITT Educational Services* (ITT Tech), the Bureau alleged that ITT Tech, a for-profit college, pressured students into enrolling by using high-pressure sales tactics and offering students special ITT Tech no-interest loans that needed to be repaid by the end of the first academic year. ITT Tech students needed these special ITT no-interest loans to fill the tuition gap between federal student aid and the cost of attending. At the end of the student's first year, the college's financial aid staff steered students through a process of refinancing the no-interest loan with private student loans that it created and managed. These loans were allegedly expensive high-risk loans that students were likely to default on. According to the CFPB's brief, ITT Tech knew its students were unable to protect their interests by using these private loans because few had the resources to pay out-of-pocket or obtain private loans elsewhere.

The CFPB alleged that the students reasonably relied on ITT Tech because it represented to its students that it would help them better their lives regardless of their financial situation. In addition, ITT Tech's financial aid staff presented themselves as subject matter experts who could advise students about financial aid. ITT's financial aid staff did not disclose that they were paid like a sales staff. Indeed, the CFPB alleged that the financial aid staff received sales training that better equipped them to steer students into these loans.

It is unlikely the CFPB could have argued that the college's conduct took unreasonable advantage of students' reasonable reliance that the college was acting in their best interest if ITT Tech did not misrepresent to its students that they were acting in the student's best interests. Expressed differently, if ITT Tech disclosed that its financial aid staff received sales training and were compensated like a sales staff, *no reasonable consumer* could believe that the staff was acting in their best interest.

In another, more recent, example, *CFPB v. SettleIt, Inc.* (SettleIt), the Bureau alleged that SettleIt, a debt-settlement business, represented to consumers that it would work in their interest only in negotiating their debt, when in fact SettleIt had financial connections with two lenders that were creditors of some consumers. The Bureau alleged that SettleIt marketed its debt collection services to consumers using contact information of debtors provided by the financially-connected lenders and favored repayment of debts to the connected lenders over other debts.

In addition, the Bureau alleged that SettleIt steered consumers to take on expensive loans from the two financially-connected lenders, while failing to disclose that SettleIt collected its debt-settlement fees from these loan proceeds. The CFPB's brief alleged that rather than protect the interests of the consumers, SettleIt concealed its financial connection with the two lenders and actively told consumers that it was not owned or operated by any of consumers' creditors.

While many of the acts and practices that the CFPB alleges that SettleIt undertook could be construed as self-dealing, the alleged abuse centers upon SettleIt's creation of a reasonable reliance by consumers that it was acting to protect their interests. Just as in ITT Tech, it would have been less likely that the Bureau could argue that SettleIt took unreasonable advantage of consumers' reasonable reliance that SettleIt was protecting consumers' interests only in negotiating debts if SettleIt had refrained from telling consumers that it was not owned or operated by any of the consumer's creditors and instead openly disclosed to consumers that it, in fact, had financial connections with two lenders.

FINDING PATTERNS IN ABUSIVE ENFORCEMENT ACTIONS

For credit unions seeking to avoid abusive acts or practices, two patterns appear from the CFPB's enforcement actions. In most of the Bureau's enforcement actions on the abusive standard, one common argument is that had the institution given clear disclosures, no reasonable consumer would have engaged in the act or practice. For example, in both NDG and Payment Funds, the Bureau viewed it unlikely that a reasonable consumer would have agreed to loan modifications knowing that the loans were unenforceable. In the Bureau's view, no reasonable consumer would have used D&D's loan referral services if they knew they would be steered toward more costly loans with unfavorable procedures. Going forward, credit unions seeking to reduce their UDAAP risk may wish to ensure that disclosures are clear and conspicuous.

The second pattern that appears is if an act or practice targets vulnerable groups, the Bureau may consider it abusive. Vulnerable groups would likely include service members, Native American tribes, and college students. ITT Tech, mentioned earlier, targeted vulnerable college students who were unable to protect their interests when selecting or using ITT Tech's private loans because few had the resources to pay out-of-pocket or obtain private loans elsewhere.