Consumer Finance Monitor (Season 3, Episode 6): The CFPB's New Policy Statement on the Dodd-Frank Abusiveness Standard: Has Anything Changed?

Speakers: Alan Kaplinsky and Chris Willis

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor podcast where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. I'm your host today Alan Kaplinsky. I'm the practice group leader of the Consumer Financial Services Group at Ballard Spahr and I'm very pleased to have as my guest today, my colleague and vice chair of the Consumer Financial Services Group, Chris Willis. And Chris is a partner in our Atlanta office ever since 2011 when the CFPB got stood up.

Alan Kaplinsky:

Chris has been at the forefront of handling CFPB enforcement and supervisory matters and during a period of approximately nine to 10 years, Chris has had to deal with one of the key issues that the industry has been greatly concerned about under Dodd-Frank that is part of the title that created the CFPB. And I'm referring to the language in Dodd-Frank, which proscribes not only unfair and deceptive acts or practices, but also so-called abusive acts or practices. And I would say that's created enormous anxiety on the part of the industry because of the vagueness of the term and uncertainty as to how the CFPB was going to apply that term in both supervisory and enforcement matters. So, first of all, Chris, welcome.

Chris Willis:

Thanks, Alan and hello podcast listeners.

Alan Kaplinsky:

Okay. So let's start right with some foundational information that I think it's important to get out on the table. What exactly does the Dodd-Frank act say about abusive conduct?

Chris Willis:

Sure. It actually contains a definition of abusive conduct. It's in section 1031D of Dodd-Frank. And basically what it says is that is abusive if number one, it materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or two, it takes unreasonable advantage of a lack of understanding on the part of the consumer, the inability of the consumer to protect their interest, or the consumer's reasonable reliance on the financial service provider to act in the consumer's interest. I'm slightly paraphrasing there, but those are the elements of abusiveness as it is defined in section 10301D of Dodd-Frank.

Alan Kaplinsky:

Okay. And Chris, based on your experience in handling dozens of CFPB enforcement matters, have you seen this as just a critical part of Dodd-Frank that has been very difficult to deal with?

Chris Willis:

Yeah. So the answer is abusiveness has not played a large role in a lot of what the Bureau has done in either supervision or enforcement since it began in 2011 on the designated transfer date. The Bureau has only occasionally relied on the abusive prong of its authority under Dodd-Frank and even less frequently has relied on it to the exclusion of the unfair and deceptive elements of the statute. Much more frequently the Bureau identifies conduct that's unfair or deceptive and takes action on one of those bases. And so the existence of the abusive authority hasn't, as a practical matter, affected the fortunes of industry participants very much since the Bureau began.

Chris Willis:

And in terms of talking about things that were difficult to deal with, what has been sometimes difficult to deal with is the agency's sort of application of unfair and deceptive in situations where the conduct doesn't appear to meet the definitions of those prongs of its authority under Dodd-Frank and the willingness of the Bureau to be expansive in interpreting those concepts. Those have directly led to much more in the way of enforcement and supervisory activity against financial institutions than anything having to do with abuse of authority.

Alan Kaplinsky:

It's an interesting point that you make Chris. Somewhere in the material that was released by the CFPB I read that I think some 30 times, or maybe 32 times, abusive has been relied upon in either a consent order or complaint filed by the Bureau, but in all cases except for two, it's always been accompanied by an allegation of unfairness or deception. So if that's the case, it sounds like the CFPB has been reluctant, at least up until now, to rely upon abusiveness as a standalone basis for proceeding against a company.

Chris Willis:

Yeah. [crosstalk 00:06:29] It's definitely fair. The empirical evidence proves exactly what you just said and if you think actually even about the couple of instances in which the Bureau relied on it in a standalone way, those were instances where arguably, under the kind of expansive view that the Bureau has taken in the past of unfair, those could have just as equally been pled as unfair violations instead of abusive. And so you're right. It hasn't really empirically played much of a role in the Bureau's activities.

Alan Kaplinsky:

So why do you suspect that there's such a brouhaha that has developed over about a decade regarding abusive, but not unfair and deception?

Chris Willis:

Well abusive was new with Dodd-Frank. We had existing federal statutes that talked about unfair and deceptive and those statutes are 100 years old, like the federal trade commission act, there was a long sort of set of standards and precedent emanating from the Federal Trade Commission and from the Federal Banking regulators enforcing the FTC act against banks about what unfair and deceptive meant. And really there was no room for industry participants to claim surprise with respect to unfair and deceptive on the basis that this was something brand new and not understood because as I said, it had been around for roughly 100 years in the form of the FTC act.

Chris Willis:

Abusive on the other hand was new and it carried with it not only ambiguity as you highlighted earlier in the podcast, but also these concepts like materially interfering with the consumer's ability to understand something. What does that mean? If you put disclosures in an agreement, how are you materially interfering with them? Is it if the disclosures aren't big enough, for example? And then there's these concepts of taking advantage of the consumer's reliance on the financial institution to look after the consumer's interest. It almost threatened to impose a fiduciary duty on financial institutions merely by the fact of serving consumer financial products and services. So there's a lot of threat in the language and it is new and so that's, I think, the impetus behind the industry reaction to it.

Alan Kaplinsky:

Okay. Well, in any event, after the change in leadership at the CFPB, director Kraninger decided it was a good idea to hold a symposium where she invited industry and consumer advocates to a symposium that was publicly made available on the internet where there was a lengthy debate about the term abusive and whether the CFPB ought to do something about it. Now, it can't just read it out of the statute, it's in Dodd-Frank and certainly this Congress isn't about to eliminate the term. So they were weighing whether to do a regulation or a policy statement. And Chris, they ultimately decided to do what?

Chris Willis:

They came out with a policy statement just recently that give some guidance to the world about how the Bureau is planning to apply abusiveness in the future, both in terms of when they may use it and how they will define it and what monetary remedies they may seek when they invoke it. So those are the three basic concepts that are covered in this policy statement.

Alan Kaplinsky:

Why do you suppose Chris that they decided to go the policy statement avenue rather than a full blown regulation? Do you have any idea?

Chris Willis:

Well, the most obvious reason is because a full-blown regulation is a very lengthy and time intensive process for the agency. They'd have to comply with the administrative procedures act rule-making provisions so they'd have to provide a notice of proposed rulemaking, solicit, and then assimilate and respond to public comments on it and then issue a final regulation. That process has generally taken at least a year for the CFPB, even for relatively simple rules, like it's larger participant rules. And so why take on the task of doing something for a year and having to deal with public comment and all of that, when you can do it as a policy statement?

Chris Willis:

And there's also the point that when you prescribe a regulation, you then create standing and anybody in the world to challenge the regulation and say it is not consistent with the underlying statute. Whereas I think it's a little more difficult to challenge a policy statement, not that it can't be done, but it's more difficult. A regulation makes it clear that everybody has standing to challenge it if they choose to do so.

Alan Kaplinsky:

Yeah. Although I think technically speaking, Chris, it would be conceivable for Congress, assuming it wanted to jump into the fray, to pass a resolution, the house, the Senate, and have to be signed by the president to override the policy statement like they did with respect to an earlier policy statement that was issued by director Cordray, dealing with the use of disparate impact theory in the auto finance world. So am I right?

Chris Willis:

Yeah. That's right, but that also sort of underlines the timing point. If the Bureau had taken the time necessary to go through the APA rulemaking process, the resulting regulation would have been delayed by probably many months as compared to a policy statement. And so instead of today's political environment where a congressional review act disapproval of what the CFPB does seems unlikely, the Bureau would have taken the risk that the election cycle at the end of this year would've made a CRA unfavorable review of the regulation more possible.

Alan Kaplinsky:

Right. Although, I suppose there is the downside part of going the policy statement route that if, as a result of the elections, the Democrats gain control of the Senate, as well as the house and we have a democratic president who appoints a new director of the CFPB, somebody who doesn't like this policy statement, it wouldn't take long to get rid of it, am I right?

Chris Willis:

No. It would be very simple. They would have no delay in doing so whatsoever. And so the policy statement is not something that can be relied on in a lasting way by industry to survive administration changes in Washington.

Alan Kaplinsky:

Yeah. So let's dig into the policy statement right now, Chris. What does it do?

Chris Willis:

So it basically has several parts to it, but the first part is to essentially say that the Bureau is planning to be more explicit about what it means when it calls something abusive. So it stated that it no longer plans to engage in what we'll call dual pleading that is taking the same conduct and saying it is both unfair and abusive, for example. It'll try to stick with one or the other, or if it does allege both, then it will be, according to the policy statement, very specific about the precise conduct that caused it to reach a conclusion that the conduct was abusive.

Chris Willis:

In other words, the Bureau is promising that in its future enforcement actions it won't simply conclude that something is abusive, but will be more specific in its pleading about stating why a particular act or practice was deemed abusive by the agency. So that's the first part of it is they're promising to be more specific in terms of identifying it with the idea of being to build up an understanding over time in industry through these regulatory precedents about what abusiveness really means.

Alan Kaplinsky:

Okay. And what else does it do?

Chris Willis:

There's a couple of other things. There's a statement in the policy statement that the Bureau will not declare an act or practice abusive unless it's harm to consumers outweighs the benefit to consumers of the practice. And that's kind of an interesting aspect to the policy statement because there's nothing about this weighing of harm and benefit in the statutory definition of abusive in section 1031 of Dodd-Frank. There is a similar weighing in the definition of unfair, which is right in the same statute, but there's nothing about the weighing of cost and benefit in section 1031D dealing with abusive, but nevertheless, the Bureau seems to be saying that if a particular act or practice has a net benefit to consumers, then it won't be deemed abusive.

Chris Willis:

And it could signal a significant change in the Bureau's thinking because there's certainly plenty of instances in the past where the Bureau has identified acts or practices that seem to harm a small number of consumers, but may benefit a large number of consumers and nevertheless found them to violate Dodd-Frank. And if really the scales are now more evenly weighed of consumer harm versus benefit, maybe those practices would not be deemed to violate the statute under today's analysis. One would hope that was the case. I don't know that it actually will be implemented that way, but that part of the policy statement certainly suggest that.

Alan Kaplinsky:

And there is a third thing that they've said regarding monetary relief.

Chris Willis:

Yeah.

Alan Kaplinsky:

And what's that?

Chris Willis:

And this one honestly is a little bit of a head-scratcher for me I have to say. What the Bureau is stating is that in instances where it identifies conduct as abusive, it will order restitution if customers are harmed, but it will not impose civil monetary penalties if the defendant acted in good faith with respect to understanding whether or not it was conduct that would be deemed abusive. And the reason I say it's kind of a head-scratcher is it's hard to think of a set of circumstances where the Bureau would have concluded that an entity's behavior towards consumers was abusive, meeting the definition set forth in Dodd-Frank, unreasonably taking advantage of their lack of understanding or preventing them from understanding or taking advantage of their trust and some of the language in Dodd-Frank, but nevertheless was acting in good faith in a way that ought to absolve the industry participant of civil monetary penalty liability.

Chris Willis:

So maybe the Bureau will find such a case in its enforcement experience in the future, but it seems like a relatively narrow intersection in a Venn diagram where the conduct will be abusive according to the Bureau, but the defendant will have acted in good faith, but nevertheless, that's what the policy statement says.

Alan Kaplinsky:

So let's say you're consulted by a client about a new product or a way of offering a new product where it appears to satisfy the definition of abusive, but the client says, "Hey Chris, can you write us a legal opinion telling us that what we're doing is not abusive? Because then if you do that, I think we'll be able to say we acted in good faith, right? We relied on competent counsel."

Chris Willis:

Someone would have to motivate me or write an opinion like that and that would be difficult to do because the standard has not been significantly clarified by this policy statement to the extent that I think it would allow anyone to want to give an unqualified opinion of X conduct is not abusive.

Alan Kaplinsky:

Right. So what is the practical import of what they've done? I get the impression from what you've said, and I tend to agree with you, that it's not going to have much of an impact. I mean, for two reasons. Number one, since Kraninger has been in office she hasn't really relied on the abuse of prong. That's number one. And when she's out of office, if there is a Richard Cordray, Jr as the new director, that person can't get rid of the policy statement.

Chris Willis:

Well both of those things are true and I think unfortunately, from an industry perspective, the policy statement is likely to have very little, if any, practical effect on the behavior of the agency. And there are two main reasons for this. One is that, as we talked about earlier in the podcast, the Bureau simply hasn't done a lot with abusive as a standalone legal theory, even since its inception, not just under the current director, but under the original director, Richard Cordray.

Chris Willis:

And so you're taking a policy statement and purporting to change how something is applied by the Bureau that they almost never relied on, at least almost never relied on in isolation. So predicting that it will then have a significant practical impact on the Bureau's behavior seems unsupported by the evidence. The second thing is that in addition to the point you made about a director in the future being able to simply delete this policy and pretend like it never happened, even if the policy remains in effect, it's not like it is that specific and that objective and verifiable in a way to allow industry to predict in advance what's abusive and what's not and to thereby gain some benefit from more certainty that it didn't have before.

Chris Willis:

Think about the discussion in the policy statement and think about the subjectivity involved in the determinations that are necessitated by the Bureau's new approach saying, "Oh. Well, does the consumer harm outweigh the consumer benefit or not?" Well that's merely a judgment call that can be made based on the judgment of whoever happens to be in the CFPB at the time. And the idea of whether the defendant is acting in good faith or not, also a subjective judgment call based on an interpretation of the evidence. So the policy statement doesn't, in my view, in any real way, constrain the behavior of the agency, even if the policy statement remains in effect. So for both of those reasons. In addition to the fact that it's potentially a fleeting policy statement that might not survive the next election cycle, I don't think it's likely to have much in the way of practical impact on the agency's behavior and it certainly has very little impact on the way I assess risk with respect to clients, operations, or products vis-a-vis the Bureau.

Alan Kaplinsky:

Yep. You said at the outset of our interview, Chris, that you were more concerned about how the CFPB is applying unfairness and deception than you were abusiveness. And I'm wondering if you could just elaborate a little bit on what you meant by that.

Chris Willis:

Certainly. So I'll go through some generic examples. If we look at the history of deception and unfairness as interpreted by the Cordray CFPB, we'll find plenty of instances where those conclusions were reached, despite the evidence seeming to indicate that they could not be supported. So for example, there was a whole series of credit card add on product consent orders totalling, as I recall, over a billion dollars in relief on the theory of unfairness, dealing with the idea that consumers had to fill out a postcard or take some action to enroll in benefits that they were being charged with. Well the definition of unfairness is an injury that the consumer cannot reasonably avoid. Well, if the consumer could have reasonably avoided the injury by filling out the postcard and sending it in, then how does that possibly meet the definition of unfair? And yet we had over a billion dollars of consent orders predicated on that very theory.

Chris Willis:

Likewise, there were numerous deception cases where the alleged facts that were deceptive were clearly communicated in disclosures or contract provisions, but the CFPB merely didn't think that they were prominent enough or clear enough. And so there were instances where industry participants made full disclosure, sometimes disclosure exactly as required by other federal statutes like the truth and lending act, and the Bureau, nevertheless, contended that there was deception visited upon consumers. It's that kind of expansive interpretation of unfair and deceptive that was the real driver behind the difficulties for industry and I would say the unfairness to industry from the bureaus enforcement efforts in the past. And of course the policy statement doesn't do anything to help with that.

Alan Kaplinsky:

Yeah. And so when people complained about the Bureau pushing the envelope, you always heard that expression, what they were really complaining about was not how the Bureau was applying abusive, but really how the Bureau was using unfairness and deception to get into areas that it probably should have stayed out of.

Chris Willis:

That's certainly one of the ways it pushed the envelope, but not the only one.

Alan Kaplinsky:

Right. Right. And I take it if you had magical powers to tell the CFPB what it should be doing to eliminate the kinds of things that you just described about how they interpreted unfairness and deception, what would you tell them? Would you tell them, "We need a policy statement dealing with unfairness and one with deception," or exactly how would you curb that?

Chris Willis:

Well the way to address the issue is to have the Bureau actually hue to the statutory definition of unfairness and the well-established definition of deception that comes out of the FTC. Deception is not defined in Dodd-Frank, but there's a longstanding tradition of interpretation of that term under the Federal Trade Commission and in case law developed by the FTC over the years. So if you faithfully apply the law as it is written in both of those areas, this problem doesn't exist, but all too often the Bureau was ready to reach conclusions of unfair or deceptive with little, if any, attention paid to whether it really conformed to the legal standard that had been annunciated in Dodd-Frank or in the FTC case law.

Alan Kaplinsky:

Okay. We've just about reached the end of our show for today, but before we sign off, Chris, is there anything more that you'd like to add on the subject we've been talking about today or do you think we've covered all the important points?

Chris Willis:

I think we've covered the important points. The main conclusion that I would want to leave the audience with is that I don't believe the policy statement changes anything in the way that we should evaluate risk with respect to the CFPB and I think it is unlikely it will significantly impact the Bureau's behavior. So this isn't a change point in the way that we deal with the Bureau or anticipate our dealings with the Bureau.

Alan Kaplinsky:

Okay. Well Chris, thank you very much for joining us today. I want to remind our listeners that if they're looking for more information on the topic that Chris and I talked about today or really any consumer financial services, product, or issue, they ought to make sure they're subscribed to our blog, also called Consumer Finance Monitor. And we also have webinars that we conduct periodically. And if you want to get on our e-invitation list for the webinars you ought to contact us. You could contact Chris or me or essentially anybody at our firm. One email address to use is podcast@ballardspahr.com.

Alan Kaplinsky:

And if you have any questions, any ideas for other topics that you would like to have us cover during our podcast show, please let us know about it. When we get communications from the industry clients and non-clients we really listen to you because we want our show to cover the most important and pressing matters that you're concerned about. Our podcast show gets a new version gets released at just about every Thursday during the year, except when a Thursday falls on a holiday. So thank you again for downloading our show today.