



# *Financial Services Management*

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## **Abusive Consumer-Finance Practices**

### **Cite**

CFPB, Policy Statement on Abusiveness

### **Recommended Distribution:**

Retail Finance, Risk Management, Corporate Planning, Legal, Government Relations

### **Website**

[https://files.consumerfinance.gov/f/documents/cfpb\\_policy-statement-of-abusiveness\\_2023-03.pdf](https://files.consumerfinance.gov/f/documents/cfpb_policy-statement-of-abusiveness_2023-03.pdf)

## **Impact Assessment**

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- The Bureau's policy is a change from fifteen years in which abuse was found to exist only when express predatory behavior was found by the Bureau, banking agencies, or other federal and state authorities. Consumers will gain additional protections but perhaps also fewer providers, higher costs, and ultimately less choice.
- The CFPB's new UDAAP framework expressly expands enforcement scope from "sins of commission" to "sins of omission" – i.e., the failure of a financial company to ensure that its business model or products overcome consumer impediments to adoption even if there are no discriminatory barriers, misleading disclosures, or other demonstrable unfair or deceptive actions.
- Abusiveness may redound to the provider when a consumer financial product includes features dictated by third parties, including those outside the CFPB's direct reach such as infrastructure services (especially those facing the consumer, pricing, or otherwise exerting transaction control), credit enhancers, and even lawyers or compliance consultants.
- Products the Bureau believes fail to provide demonstrable consumer benefit may be abusive even if a consumer freely chooses them and all relevant representations are complete and accurate.
- The agency's view that certain indicia of market power (e.g., lack of portability) are abusive expands the agency's focus on "fair access" by making it a de facto antitrust enforcement agency.

## **Overview**

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Following its usual practice of setting standards by edict, the Bureau of Consumer Financial Protection has laid out an extensive framework that brings a wide range of consumer-finance actions and inactions within the scope of enforcement sanctions governing acts or practices that are not only unfair or

deceptive, but also abusive. As a result, consumer-finance providers and the third parties on which they often rely have considerably more legal and reputational risk even as consumers may be better insulated from actions that disadvantage or even harm their financial prospects. Much of the new policy requires providers to protect the most vulnerable of any possible consumer for all aspects of a product or service, structuring all aspects of product offerings, pricing, marketing, infrastructure, and long-term provision to a consumer's advantage as the Bureau defines it.

## Impact

The Bureau insists that this policy sets no new UDAAP standards, citing in support of this not only its own 2020 UDAAP policy<sup>1</sup> and 2022 UDAAP-focused changes to the examination manual,<sup>2</sup> but also statements by the Federal Trade Commission. Thus, while the Bureau's policy may not be novel in terms of overall federal standards, it appears to go considerably farther than prior CFPB statements; typically, federal agencies issue rules with prior notice and comment if they change their own standards no matter what another agency has done in part because, even if standards appear the same, governing law may well differ. The Bureau is already facing litigation challenging its approach to setting standards without formal rulemaking and this consideration among others will surely add the new UDAAP policy to those being challenged.

As discussed below, the Bureau takes a very expansive view of what is abusive, eschewing findings only of intent by a consumer-finance provider, injury or cost to the consumer, or evidence that most consumers are able to protect themselves from representations, features, or other aspects of a product or service and have ample choice among possible providers. As a result, the policy puts providers at risk of a costly UDAAP determination in many cases where current market practice and legal opinion have yet to establish liability. Notably, the cases the Bureau cites in describing its views are often instances in which a provider has actively deceived a consumer, offered broadly-misleading disclosures or legal documentation, placed consumers in harm's way (e.g., false account opening), or failed to adhere to sound underwriting based on circumstances at the time of loan origination. Thus, the examples of relevant actions often do not support the grounds on which the Bureau now says they may be based.

For example, consumer-finance providers could be found abusive if the Bureau believes that their business model puts consumers at risk. Abuse may also occur if product design accrues to the provider's benefit – i.e., via higher profit, greater market share, a different brand reputation, or even operational improvements. These and other standards in the policy in essence require consumer-finance providers to offer the best possible terms and conditions even if doing so does not achieve a firm's strategic ends. It is unclear how many providers will remain in this sector if they cannot advance their business interests without significant legal and reputational risk.

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<sup>1</sup> See **UDAP6**, *Financial Services Management*, January 31, 2020.

<sup>2</sup> See **CONSUMER39**, *Financial Services Management*, March 22, 2022.

The Bureau's policy also reinforces the authority it claimed in last year's examination manual over third parties – e.g., mortgage insurers or securitizers – over whom it lacks direct enforcement power by virtue of a finding that abuse may occur if consumers cannot choose all the third-party providers associated with a product over the life of the product relationship. Backroom services (e.g., loan pricing, consumer-facing marketing, origination decisions) as well as third-party credit enhancers, servicers, and securitizers appear to also come under this choice requirement, but it is unclear how consumers could be offered choice among all the third parties associated with many retail-finance products in a way that meets all the Bureau's other edicts for fairness, direct consumer benefit, and transparency. The Bureau assumes that offering third-party choice will ensure consumers get the best price and service, but it could actually so increase product-choice complexity as to disadvantage all but the most sophisticated consumers. Any advice a firm or third parties provide on this choice would need to be in the consumer's best interest under the policy, adding both consumer protection and third-party legal and reputational risk with uncertain implications on retail-finance product design not addressed in the analysis accompanying this policy.

Finally, the policy reaches to any instance in which a consumer may have a reasonable expectation that a provider acts on his or her interest. The sweeping nature of the Bureau's statements here create a de facto fiduciary obligation for any provider who offers products guiding consumer decisions or actions as well as even marketing describing a product's benefits in what the CFPB decides are unduly glowing terms.

## What's Next

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The CFPB released this policy on April 3, setting a comment deadline of July 3 even though the policy is effective upon publication in the *Federal Register*. In addition to possible direct legal challenge, this policy could also be invalidated if the Supreme Court broadly finds against the Bureau on constitutionality grounds later this year. Republicans are also likely to initiate action to reverse the policy under the Congressional Review Act, action likely to succeed in the House, face hurdles in the Senate, and be vetoed by President Biden should it reach his desk.

## Analysis

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Under the law establishing the CFPB and its abusiveness powers,<sup>3</sup> an abusive act or practice “materially interferes” with a consumer’s ability to understand a product’s terms or conditions or takes “unreasonable advantage” of the consumer expectations or abilities. Abusiveness does not require a showing of substantial liability, according to the Bureau, with the analysis provided in this statement going on to detail numerous situations in which the agency believes abuse is likely (see below).

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<sup>3</sup> See **CONSUMER14**, *Financial Services Management*, July 19, 2010.

The Bureau does not need to find intent to find abuse.

### ***A. Material Interference***

The CFPB interprets this as occurring not only when there is an attempt to mislead a consumer about terms and conditions, but also when it is the “natural consequence” of a consumer’s ability to understand. Examples include:

- “burying” disclosures;
- omitting key terms;
- taking physical or digital actions that obscure or hide terms (e.g., multiple drop-down menus); and
- overshadowing, when content obscures key terms.

Provision of a product or service also interferes with a consumer’s ability to understand if the product or service is so complicated that material information about it cannot be sufficiently explained or if the entity’s business model functions in a manner that is inconsistent with its product’s or service’s apparent terms.

### ***B. Unreasonable Advantage***

#### ***1. Framework***

Congress is said to define unreasonable advantage regardless of a provider’s actions as taking advantage of:

- consumer misunderstanding; and
- a consumer’s inability to protect him or herself, a result the Bureau believes occurs when consumers have inadequate bargaining power or are unable easily to switch providers; or
- a consumer’s reasonable expectation that the financial institution will act in the consumer’s interest.

Notably, although the statute and these definitions expressly address unreasonable advantage, the Bureau also finds that unreasonable advantage occurs when behavior accrues to the institution’s, not consumer’s, interest in monetary or non-monetary ways – e.g., greater market share or reputational or operational benefits. Although the statute and these definitions address “unreasonable advantage,” the policy also states that a consumer’s lack of understanding suffices for abuse” and abusiveness need not be limited only to cases in which more than a single consumer has been taken advantage of. Adverse consequences need only be in the “realm of possibility” for harm (e.g., default) or unreasonable advantage to occur. By this reading any instance of loan default could be UDAAP even if a lender has no evident pattern or practice of offering loans to borrowers without ability to repay if only a single borrower is harmed. However, the Bureau also says in a footnote that enforcers may rely on a finding that reasonable consumers could have protected themselves to decline to take enforcement action.

No finding of injury is required for unreasonable advantage. Further, even a small advantage may be abusive if it is unreasonable. By this logic, it is possible that a consumer-finance provider could be found to have engaged in an UDAAP if an operational action delays consumer benefit (e.g., access to funding) designed to ensure safe and sound finance in order to protect the firm's reputation. Direct evidence that consumers assert a lack of understanding (e.g., via complaints) may also suffice even if many consumers reasonably understood the product. Transactions without demonstrable benefit to a consumer may also take unreasonable advantage, a finding that enforcers may reach even if a consumer initially perceived benefit if the enforcer does not think it suitable.

Examples of unreasonable advantage include:

- mortgage products designed to fail because the lender is protected from default risk by virtue of securitization. It should be noted that most mortgages sold into the secondary market were not “designed to fail” despite this incentive misalignment that led to considerable volumes of loans successfully sold not only because of the lack of downside risk, but also faulty secondary-market underwriting. The Bureau's statements here suggest that any loan sold into the secondary market that then defaults or even becomes delinquent may be UDAAP;
- products that deny consumers key legal rights (with the Bureau here apparently meeting the right to pursue class-action litigation); and
- provider receipt of a “windfall” due to the consumer's inability to bargain.

## 2. **Market Power**

The overall framework of findings of unreasonable advantage in this area also depend on the Bureau's judgment of whether a consumer as “autonomy,” i.e., choice with regard to monetary and non-monetary results that do not meet the consumer's interests or cause troublesome (e.g., undue delays for problem) resolution. Abuse may occur even if a consumer can protect himself or herself if it is impractical to do so.

The nature of a relationship may also be abusive when consumers have no choice but to accept a third party such as a mortgage servicer, credit reporting agency, and debt collector. As noted, this has broad implications not only for targeted third parties, but also for many others that often have considerable influence over consumer-finance product design, cost, marketing, safety, and profitability.

Consistent with prior proposals the Bureau also states that consumer-finance companies may not take unreasonable advantage through the use of form contracts.<sup>4</sup> This proposal applies only to nonbanks, but the Bureau in this

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<sup>4</sup> See **CONSUMER48**, *Financial Services Management*, January 19, 2023.

policy appears not only to have finalized its proposal, but also expanded it to banks. Market power that limits a consumer's ability to extricate a household from a particular provider may thus take unreasonable advantage and be found abusive.

### **3. *Reliance***

As noted, abusiveness may also occur where consumers have a reasonable expectation that they may rely on provider to act or advise in the consumer's interest. Reasonable expectations may exist when:

- when a provider communicates or implies to the consumer or public that it acts in a consumer's best interest; and
- a provider acts on behalf of consumers or helps them to select providers.

As noted, this applies a fiduciary standard to all providers that offer advice, product comparisons, or other services, also governing marketing in which products are said to advantage a consumer.