From the Examiner's Desk: Unfair and Deceptive Acts and Practices: Recent FDIC Experience

This regular feature focuses on developments that affect the bank examination function. We welcome ideas for future columns. Readers are encouraged to e-mail suggestions to ***SupervisoryJournal@fdic.gov.***

The Winter 2006 issue of ***Supervisory Insights*** featured an article that serves as a "field guide"[1] to unfair or deceptive acts or practices (UDAPs) under Section 5 of the Federal Trade Commission Act (FTC Act). As noted therein, "UDAPs are not always apparent or easily discovered," making compliance and compliance supervision in this critical area especially challenging.[2] To aid compliance professionals in meeting their UDAP oversight responsibilities, the FDIC's Division of Supervision and Consumer Protection (DSC), during an 18-month period,[3] surveyed UDAP issues identified and analyzed through the FDIC's examination-consultation process.[4]

This article highlights the methodology used by FDIC examiners (and other staff) to analyze the FTC Act (Section 5) UDAP issues surveyed during this period. Each FTC Act violation determination turns

UDAP and Overdraft Protection Practices

The primary focus of this article is on the analytics used in determining an FTC Act violation, rather than on actual practices. However, it is important to note the following about practices observed specific to overdraft protection programs and services. Though the FDIC has previously issued substantial guidance relating to unfair or deceptive overdraft protection practices,[5] the most common FTC Act violations identified by FDIC examiners during this 18-month UDAP survey involved overdraft protection programs and services. The following were typical overdraft protection practices analyzed by examiners and other FDIC staff for compliance with the FTC Act during this period:

- Including the available balance of an overdraft line of credit (ODLOC) when disclosing a deposit account balance, particularly at automated teller machines (ATMs).
- Failing to disclose accessibility of ODLOC via ATMs, point-of-sale (POS) transactions, online banking, or preauthorized transfers.
- Erroneously disclosing inaccessibility of ODLOC via ATMs, POS transactions, online banking, or preauthorized transfers.
- Promoting overdraft protection services without informing the depositor of (or overstating) the maximum dollar amount of protection or without disclosing fees associated with service.
- Using the word "free" (when charges are imposed) and other misleading representations in overdraft protection advertisements.
- Enrolling depositors in overdraft protection programs without their knowledge or consent and, subsequently, approving withdrawals at ATMs that overdraw a depositor's account, resulting in the imposition of fees.

Bank compliance officers should reference FDIC overdraft protection guidance and, along with FDIC examiners, remain vigilant in ensuring overdraft protection programs and services are conducted responsibly and comply with all applicable laws and regulations.

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[1] Deirdre Foley and Kara L. Ritchie, "Chasing the Asterisk: A Field Guide to Caveats, Exceptions, Material Misrepresentations, and Other Unfair or Deceptive Acts or Practices" (*Supervisory Insights*, Winter 2006), https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin06/siwinter06-article2.pdf.

[2] Foley and Ritchie, 2006, p. 2.

[3] Survey of FTC Act, Section 5 consultations conducted between January 2007 and July 2008.

[4] To ensure the highest degree of consistency and uniformity throughout the supervisory and enforcement functions of the agency, the FDIC maintains a consultative process applicable to several compliance examination matters, including Section 5 of the FTC Act. Depending on the issue, a "consultation" may be anything from a simple phone conversation or a series of e-mails to formal memoranda among field, regional, and Washington FDIC staff members. These communications are instrumental in maintaining the quality and consistency of compliance, fair lending, and Community Reinvestment Act examination and supervision. Consultations ensure that senior Division of Supervision and Consumer Protection officials are alerted to significant or unusual supervisory issues and that those issues receive appropriate and timely consideration. The examination-consultation process also helps the FDIC develop more responsive and effective compliance policies and regulations. (Examiners see "Division of Supervision and Consumer Protection Memorandum System, Class. No. 6456" (May 7, 2004).)

[5] See FIL-11-2005, "Overdraft Protection Programs Joint Agency Guidance" (February 18, 2005), id. Examiners also see DSC memoranda "Examiner Guidance: Joint Guidance for Overdraft Protection Programs" (April 18, 2005) and "Deceptive Practices: Customer Access to Overdraft Protection" (March 27, 2007).

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on the specific facts and circumstances presented. Thus, while a number of practices are identified and addressed, this article is *not* intended, nor does it attempt, to list a series of citable FTC Act violations.[6] Rather, the goal of this article is to impart, through examples, a better understanding of the approach for determining UDAP violations.

An examiner has discretion to discourage a particular banking practice, regardless of whether that practice is determined to be an FTC Act violation. The FDIC expects all banks to engage in fair and ethical behavior toward consumers and adopt best business practices, including those identified in guidance issued by the FDIC.[7] Failure to do so exposes banks to a variety of risks, even where some practices may not constitute a violation under Section 5 of the FTC Act.

Unfair or Deceptive: A Test for Each

The standards for determining whether an act or practice is unfair or deceptive are independent of each other.[8] Although a specific act or practice may be both unfair and deceptive, an act or practice is prohibited by the FTC Act if it is *either* unfair or deceptive. Whether an act or practice is unfair or deceptive, in each instance, will depend on a careful application of the appropriate standard to the particular facts and circumstances. What follows is a discussion, based on examples from FDIC UDAP examination-consultations (consultations), of analyses performed by FDIC staff (consultants) in determining the existence of a violation of Section 5 of the FTC Act. The representative sets of facts in these particular consultations relate to advertising and credit card lending.

Deceptive Advertising Practices: What Makes an Act or Practice Deceptive?

As stated by the Federal Trade Commission (FTC)[9] and subsequently adopted by the FDIC,[10] a three-part test is used to assess whether a representation, omission, or practice is deceptive under Section 5 of the FTC Act:

1. The representation, omission, or practice *must mislead or be likely to mislead* the consumer;
2. The consumer's interpretation of the representation, omission, or practice must be *reasonable under the circumstances*; and,
3. The misleading representation, omission, or practice *must be material*.

The practices described below are only illustrative of each component of the three-part test for deception. Their inclusion (and any finding that the examined practices satisfy one part of the test) should *not* be interpreted as an ultimate finding that the practices are deceptive in violation of Section 5 of the FTC Act.

Advertising Consultation #1: Mislead or Likely to Mislead

For a representation, omission, or practice to be deceptive under Section 5 of the FTC Act, it must mislead or be likely to mislead a consumer. The facts in Advertising Consultation #1 describe

[6] For a list of some specific citable FTC Act violations, see Regulation AA (12 CFR 227), which specifically prohibits unfair credit contract provisions, unfair or deceptive cosigner practices, and unfair late charges.

[7] For example, see FIL-11-2005, "Overdraft Protection Programs Joint Agency Guidance" (February 18, 2005), www.fdic.gov/news/news/financial/2005/fil1105.html.

[8] FIL-26-2004, "Unfair or Deceptive Acts or Practices by State-Chartered Banks" (March 11, 2004, p. 1), www.fdic.gov/news/news/financial/2004/fil2604a.html.

[9] "FTC Policy Statement on Deception" (October 14, 1983, p. 5), www.ftc.gov/bcp/policystmt/ad-decept.htm.

[10] FIL-26-2004, p. 3; and see Foley and Ritchie, 2006, p. 2.

how a bank used direct marketing to solicit credit card business. To entice potential customers, the bank's credit card solicitations prominently featured a Cash Back Reward program (i.e., use of the credit card would garner cash awards; the greater the card's use, the greater the rewards). In determining whether the bank's solicitation practices were likely to mislead consumers, the consultants reviewed five documents comprising the solicitation (a mailing envelope, a folded brochure, a solicitation letter, an application form, and a summary of terms and conditions) and found the following:

- The phrase "6% Cash Back" appears 13 times in the solicitation materials. Notably, the promise of 6% Cash Back on certain categories of purchases is unqualified, whereas the promise of 2% Cash Back on "all other purchases" is qualified by the words "up to."
- The "6% Cash Back" phrase appears three times in the solicitation letter, in each case not qualified with the phrase "up to."
- None of the instances of the "6% Cash Back" phrase in the solicitation documents are qualified with a phrase such as "up to;" nor is there an asterisk or footnote in proximity to any of the references referring the consumer to additional information. The application and solicitation documents do not indicate any material limitations on the "Cash Back" offer.
- The Solicitation also contains a booklet entitled "Summary of Credit Terms and Conditions." On the fourth page of this document, and in very small font, the program's limitations are listed. The section, entitled "Cash Back Rewards Program Rules," explains the methods of calculating the cash back amount of the reward that the customer actually receives.

In concluding that the bank's credit card solicitation practices were likely to mislead a consumer, the consultants noted that the bank promoted "6% Cash Back" in 13 places throughout the solicitation documents. The consultants further observed that the bank failed to adequately disclose that the actual "Cash Back" reward in a chosen bonus category is tiered, with only 0.5% earned on the first $10,000 in purchases, and with the maximum "6% Cash Back" earned only on "Bonus category qualifying purchases" between $40,001 and $50,000. Additionally, the solicitation failed to disclose (or otherwise qualify), in close proximity to any of the 13 occurrences of the phrase "6% Cash Back," the tiered nature of the "Cash Back" reward structure. Also, the bank's use in its solicitation of the qualifying words "up to" for *non*-bonus category purchases (e.g., "and up to 2% Cash Back on all other purchases") tended to reinforce a message that a tiered structure for bonus category purchases (a category which would seemingly always earn "6% Cash Back") did not exist. In addition, the consultants found that the solicitation was misleading in that no "Cash Back" reward at all is paid unless and until the earned rewards within the year reached $50. Consequently, to receive any bonus, a consumer would have to spend at least $10,000 on purchases ($10,000 x .50% = $50) in their Bonus Category between the time the card is issued and the closing date of his or her twelfth statement. The consultants noted that the bank's repetitive use of the phrase "6% Cash Back," lacking any qualification, falsely suggests that a 6% bonus is immediately available on all bonus category purchases.

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Advertising Lesson #1: Representations should be sufficiently qualified within an advertisement or direct solicitation to avoid the likelihood of misleading consumers. Furthermore, the likelihood of a consumer being misled by an advertisement or direct solicitation increases with the repetitiveness of the unqualified representation. In Advertising Consultation #1, the bank repeatedly promoted "6% Cash Back" throughout its solicitation documents when, in practice, due to the "tiered" structure of the Reward Program, the reward earned was far less than the amount stated in the solicitation documents. In fact, as a result of the program's "tiered" structure, the consumer could *never* earn, on overall purchases, the amount of rewards stated in the solicitation. Thus, the consultants concluded that the bank's practice of omitting qualifying information in its credit card solicitation materials concerning its Cash Back Reward program was likely to mislead consumers.

Advertising Consultation #2: Reasonable Interpretation

In determining whether a consumer's interpretation of a representation, omission, or practice is reasonable, the *totality of the circumstances and the net impression* of the solicitation must be evaluated. For instance, in Advertising Consultation #1, the consultants found that, viewed as a whole, the credit card solicitation was likely to mislead a reasonable consumer in that it gives the false impression that a 6% cash bonus is available for all purchases in a chosen bonus category.

In Advertising Consultation #2, a consumer's interpretation of a representation and omission was deemed reasonable given the totality of the circumstances and the net impression made. Here, a consumer complained that she received a direct mail solicitation from a bank offering her zero percent interest for 12 months on balance transfers to a new credit card account (new card). She accepted the offer by applying for the new card and requesting a balance transfer on July 3, 2005. A new card account was opened in her name on July 3, 2005. Her balance transfer ($6,000) was posted to the new card account on July 12, 2005, and appeared on the July 2005 periodic statement, which had a closing date of July 24, 2005. Thereafter, she made at least minimum monthly payments as required. She made no other charges, either purchases or cash advances, on this account. When she received the July 2006 periodic statement (which had a closing date of July 24, 2006), she sent a payment for the outstanding balance before the due date reflected on the statement. This payment was posted to her new card account on the actual due date: August 13, 2006. Nevertheless, the bank assessed finance charges, beginning on July 24, 2006, of $19.89, representing interest at the standard rate for purchases on the average daily balance of the account for the July 24–August 23, 2006, billing cycle.

The bank never disclosed to the consumer the actual date that her 12-month promotional zero percent rate would end. In addition, it was difficult for the consumer to accurately calculate the date, given the conflicting and confusing information contained in the direct mail solicitation for the promotional offer and in the card member agreement sent to her when she accepted the offer.

The bank stated that it does not send cardholders any kind of disclosure advising them when the promotional zero percent interest rate expires, because the bank does not know when the balance transfer will be made, how many transfers will be made, and when each one will be processed. Therefore, the bank left it to the consumer to determine when the 12-month promotional period expires based on when the transfer is transacted on the account. The direct mail solicitation to which the consumer responded contained the following information, which became part of the consumer's agreement with the bank:

> ***AS IF 0% INTEREST WASN'T ENOUGH OF A REWARD***
>
> ***0% APR ON BALANCE TRANSFERS FOR 12 MONTHS.*** *Pay off all your high-rate cards and get the most out of [new card account].*
>
> *No interest for 12 months. No annual fees. Lots and lots of rewards.*
>
> ***IMPORTANT INFORMATION REGARDING YOUR APPLICATION***
>
> - *Balance Transfer APR: 0% during the first twelve months of Cardmembership on balance transfer requests submitted on this application.*
>
> *Information on Balance Transfers. I understand that finance charges will begin to accrue at the time a check is issued to my current credit card institution.*
>
> ***0% APR ON BALANCE TRANSFERS FOR 12 MONTHS.*** *Pay off all your high rate cards and get the most out of [new card account].*
>
> *[Footnote]: Please note this balance transfer rate applies to balance transfer requests submitted with this acceptance certificate. Then, the balance transfers will receive the standard purchase APR unless otherwise notified.*

As stated, for an act or practice to be misleading, the consumer's interpretation of the representation, omission, or practice must be reasonable. In determining whether a consumer's interpretation is reasonable, it is appropriate to look at the entire advertisement, transaction, or course of dealing to determine how a reasonable consumer would respond. In this consultation, it was determined that the consumer's interpretation of the promotional offer and disclosures was reasonable, especially in light of the entire course of dealing between the parties. Here, the consumer received monthly periodic statements showing the remaining balance of the transfer, credit for payments remitted, the new balance, and no finance charges. This was repeated each month for 12 months with no notice from the bank at any time that the new balance on the monthly statement had to be paid by a certain date to avoid finance charges. There was nothing in this course of dealing to warn the consumer that her interpretation of the term of the promotional offer was incorrect (or was not shared by the bank).

Although other interpretations were possible, given the totality of the circumstances and the net impression under the facts in Advertising Consultation #2, the consumer's interpretation of the bank's representation and omission was deemed reasonable.

Although not discussed in Advertising Consultation #2, it must be noted with respect to reasonableness, as the analyses in many of the consultations remind us, where a particular group is being targeted by a bank's representations or marketing practices (for example, the elderly, students, or the financially unsophisticated), the reasonableness of a consumer's interpretation of the representation or practice must be judged from the vantage point of a reasonable member of the targeted group.[11]

Advertising Lesson #2: Diligence must be exercised to ensure that (1) representations made in advertisements are accurate, clear, and sufficiently informative to convey to consumers the message intended and (2) ongoing communications made throughout the account relationship reinforce, not controvert or cloud, the intended advertised message. Here, the consultants concluded the consumer's interpretation of the conflicting representations or repeated omissions, as to when the zero percent promotional interest rate expired, was reasonable given the totality of the circumstances and the net impression.

[11] FIL-26-2004, p. 3; see Foley and Ritchie, 2006, p. 2.

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Advertising Consultation #3: Materiality

To find a representation, omission, or practice deceptive under Section 5 of the FTC Act, the representation, omission, or practice must be *material*. A representation, omission, or practice is material if it is likely to affect a consumer's decision regarding a product or service. Representations about costs are presumed material. Omissions about costs are presumed material when the bank knew or should have known the consumer needed the omitted information to evaluate the cost of a product or service.[12] For instance, in Advertising Consultation #2, the consultants concluded not only that the consumer's interpretation of the bank's representations and omissions was reasonable with respect to when the zero percent introductory interest rate period expired, but that the representations and omissions were material to the consumer's decision regarding when to pay off the outstanding card balance.

In Advertising Consultation #3, the facts present a clear example of materiality within the context of Section 5 of the FTC Act. Here, the bank regularly ran advertisements in local newspapers, on the radio, and through a direct mail campaign that claimed that customers would receive free credit reports. Typically, the language in these advertisements stated: "Call for a **FREE CREDIT REPORT**" or simply **"FREE Credit Report."** The representation of a free credit report was neither qualified nor conditioned in the advertisements. If a consumer asked for a copy of the report, it was provided free to the consumer. However, if that consumer ultimately applied for and was granted credit, the cost of the credit report would be charged to the consumer at closing. Nothing in the bank's records or promotions suggest that consumers were told they would be charged a fee for the "free credit report" if they accepted a loan.

In this instance, the bank's representation that consumers would receive a free credit report is clearly material. The consultants in this case cited several court cases in which the court affirmed the FTC's position that information regarding the price of goods or services is material, because price is likely to affect a consumer's choice of or conduct regarding a product.[13] The consultants also noted the FTC's recognition of the extraordinary drawing power of the use of the word "free" in these situations.

> All advertisements are designed to excite demand for the advertised article and to call attention to the particular product. But when a prospective customer is offered something "free," it is not unreasonable to assume that the conscious or subconscious appeal involved in the offer will influence his judgment; the value of the so-called "free" article will divert the customer from the major inquiry into the quality of the article or of competing articles.[14]

It is important to note that a deceptive representation can be expressed, implied, or caused by a material omission. In Advertising Consultation #3, the bank's omission from its advertisement of a free credit report—and subsequent communications—that the consumer, in fact, would be charged the cost of the credit report if the consumer accepted a loan was material.

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[12] Foley and Ritchie, 2006, p. 4.

[13] See *FTC v. Crescent Publishing Group*, 129 F. Supp. 2d 311, 321 (S.D.N.Y. 2001) quoting *Thompson Medical Co.*, 1984 FTC LEXIS 6, 372.

[14] *Matter of Book-of-the-Month-Club, Inc. et al.*, 1952 FTC LEXIS 5 at *26-27 (1952).

Advertising Lesson #3: Representations that go to the heart of a consumer's decision with respect to a bank product or service must be carefully reviewed and monitored for accuracy and clarity. The FDIC deems representations about costs, benefits, or restrictions on the use or availability of a product or service to be material.[15] In Advertising Consultation #3, the bank advertised free credit reports without qualification or condition. However, in practice, when a consumer applied for and was granted a loan, the bank would charge the cost of the credit report to the consumer at the loan closing.

Unfair Credit Card Lending Practices: What Makes an Act or Practice Unfair?

As stated above, the standards for finding an act or practice deceptive have been established by the FTC and adopted by the FDIC.[16] However, unlike deception, the standards for finding an act or practice *unfair* are codified in Section 5 of the FTC Act.[17] With limited exceptions,[18] whether an act or practice is unfair under Section 5 of the FTC Act must be judged against the three statutory standards. Historically, enforcement actions brought by the FTC and others have focused on deception. However, recent history shows a significant increase in enforcement actions brought under the FTC Act's unfairness standards.

The statutory standards for unfairness are as follows:

1. The act or practice must *cause or be likely to cause substantial injury* to consumers.
2. Consumers must *not reasonably be able to avoid* the injury.
3. The injury must *not be outweighed by countervailing benefits* to consumers or to competition.[19]

In addition to these standards, the FTC Act allows public policy to be considered in determining whether an act or practice is unfair.

The practices described below are illustrative of each component of the three-part test for unfairness. Their inclusion (and any finding that the examined practices satisfy one part of the test) should *not* be interpreted as an ultimate finding that the practices are unfair in violation of Section 5 of the FTC Act.

Credit Card Lending Consultation #1: Cause or Be Likely to Cause Substantial Injury

To find an act or practice unfair, it must *cause or be likely to cause substantial injury* to consumers. Substantial injury usually involves monetary harm.[20] Trivial or merely speculative harms (e.g., the emotional impact of an act or practice) are typically insufficient for a finding of substantial injury. However an act or practice that causes (or is likely to cause) even a small amount of monetary harm to one person may meet the substantial injury standard if the act or practice

[15] FIL-26-2004, p. 3.

[16] "FTC Policy Statement on Deception" 1983, p. 5; see FIL-26-2004, Id., p. 3.

[17] Section 5(n); 15 U.S.C. 45(a).

[18] Regulation AA specifically prohibits certain credit practices, such as the pyramiding of late fees.

[19] Section 5; 15 U.S.C. 45(a).

[20] However, substantial injury may involve other forms of harm. For instance, unwarranted health and safety risks may also support a finding of unfairness. For an example, see *Philip Morris, Inc.,* 82 F.T.C. 16 (1973) (a consent agreement in which respondent had distributed free-sample razor blades in such a way that they could come into the hands of small children). And while emotional harm typically is not sufficient to find substantial injury, under certain circumstances (e.g., emotional harm caused by unfair debt collection practices), such harm could be sufficient to find substantial injury.

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results in (or is likely to result in) harm to a large number of people.

A review of the facts presented in Credit Card Lending Consultation #1 demonstrates how a monetary harm, in the aggregate, was found substantial by consultants even if the harm, on a case-by-case basis, was small. Here, the bank allocated credit card payments (i.e., the required minimum payment) on accounts with multiple-rate tiers in such a way as to credit the balances with lower annual percentage rates (APRs) first. Specifically, for all accounts with multiple-rate tiers (i.e., separate APRs for purchases, cash advances, balance transfers, promotional rates, etc.), the bank applied the consumer's monthly payment exclusively to the lowest rate tier, potentially resulting in the capitalization of interest to the balance with the highest rate. For example, where a customer has both a purchase balance and a balance transfer balance, the lower APRs are typically assigned to balance transfers and the highest assigned to purchase balances. As a result, any payments made by the customer would first be applied exclusively to the balance transfer balance. Unless the payment completely pays off the balance transfer balance, the interest accrued on the purchase balance is capitalized, and the balance increases.

In finding the substantial injury element of the unfairness standard met, the consultants noted how the harm suffered was monetary and concluded that the harm was or could be substantial when multiplied by all cardholders with accounts that had multiple-rate tiers. This standard is met regardless of any actual injury experienced, as long as substantial injury is a *likely result* of the act or practice.

Credit Card Lending Lesson #1: Injury caused to a group of consumers by a bank's practices, in its totality, may be judged substantial by the FDIC; injury of a similar nature limited to only one consumer may not. Therefore, banks should routinely examine their business practices to ensure such practices do not (or are not likely to) substantially injure consumers, either individually or in the aggregate. In Credit Card Lending Consultation #1, the bank allocated credit card payments on accounts with multiple-rate tiers first to balances with lower APRs, potentially resulting in the capitalization of unpaid interest to balances with higher APRs. While the harm (or likely harm) to one cardholder caused by this practice arguably may not have been substantial, when multiplied by all cardholders with rate-tiered accounts, such harm (or its likelihood) was determined to be substantial.

Credit Card Lending Consultation #2: Not Reasonably Avoidable

To find an act or practice unfair, the injury caused by the act or practice must not be reasonably avoidable by consumers. In Credit Card Lending Consultation #2, the bank periodically sent convenience checks to its customers along with their regular credit card statement indicating the offer to use the checks is good until a certain date. The checks are drawn against the customers' credit card accounts and can be used to obtain cash, purchase goods or services, or pay the outstanding balance on another credit account. They are mailed to consumers unsolicited.

Use of the convenience checks is monitored by the bank and can trigger a verification of credit (as disclosed in the card agreement). Their use may represent one factor in the bank's decision to reduce a customer's line of credit. (The account card member agreement discloses the bank's ability to change a customer's line of credit "without notice" and "at any time.") The bank stated that the reasons for reductions of credit limits are obtained from a review of the credit report and a review of its own, internal information.

Here, a customer had his credit limit reduced after using a convenience check but before the check was presented for settlement. The customer first learned of the credit reduction in a letter from the bank dishonoring the check and advising him of the credit reduction. (In many cases, it is the bank's practice to honor the check, but in so doing, triggering unintended overdraft services and costs to the consumer.)

As a result of this practice, the customer's check bounced, causing a variety of harms to the customer. For instance, when the check was declined (because it would have caused the customer's credit limit to be exceeded), the customer still owed the debt that the check was originally written to cover. In addition, the customer may be liable for fees resulting from the check not being honored. For example, the payee may pass on the cost of the bounced check to the consumer and, depending on what the check was for, may assess a late fee against the consumer if the check was used to pay a bill that then became past due. Once the check is written, if there is a decrease in the credit line such that the bank will not cover the check, the harm to the bank's customer is unavoidable.

Credit Card Lending Lesson #2a: Banks should monitor their business practices to reduce the likelihood of harm to consumers, especially harm that consumers cannot reasonably avoid. In Credit Card Lending Consultation #2, customers of the bank were not reasonably able to avoid the harm caused by a bounced check drawn against a credit card account. Here, a check bounced solely because the bank, unbeknownst to the customer, reduced the customer's credit limit after the customer had already issued the check, but before the check was presented for settlement.

Credit Card Lending Lesson #2b: Banks should structure their practices to enable their customers to make informed decisions about the products and services they choose to purchase and use, and to operate under reasonably reliable expectations about any costs/consequences associated with those decisions.

Credit Card Lending Consultation #3: Not Outweighed by Benefits

To find an act or practice unfair, the injury caused by the act or practice must *not be outweighed by countervailing benefits* to consumers or to competition.

In Credit Card Lending Consultation #3, as in Consultation #1, the bank offered a credit card account composed of multiple balances, each of which was subject to a different APR.[21] The bank allocated the required minimum credit card payments to this account in such a way as to credit a payment to the lower-rate balances first, potentially resulting in the capitalization of interest to the balances with the highest rates.

Although the consultants found this practice to be injurious to consumers (i.e., longer amortization periods and, thus, higher costs for the higher rate balances; see Credit Card Consultation #1), and the harm not reasonably avoidable, the consultants determined the injury was, in this instance, outweighed by the benefits in the form of low promotional rates for balance transfers and similar promotional rates (e.g., introductory low rates for new accounts). Determining whether this element of the unfairness test is met (i.e., whether an injury is outweighed by countervailing benefits) turns on the facts of each case; though the consultants in Credit Card Lending Consultation #3 found the injury outweighed by the

[21] The circumstances in Credit Card Lending Consultation #1 are instructive for purposes of demonstrating the third prong of the unfairness standard and, therefore, are revisited and referenced here as Consultation #3.

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benefits, a different finding may result from different facts.[22]

Credit Card Lending Lesson #3: Banks should closely examine, monitor, and test their business practices to confirm the benefits associated with those practices (be they related to a product or service), in their net effect, outweigh any harm resulting from such practices. For instance, while certain payment allocation practices in isolation may appear onerous and unfair, such practices, in their net effect, may benefit consumers and competition (e.g., the availability of low-rate balance transfers or other promotional rates). In addition, practices that do not result in a fair exchange of value between banks and their customers are likely contrary to best—and *sustainable*—business practices, as evidenced by current macroeconomic and financial events.[23]

Credit Card Lending Consultation #4: Contrary to Public Policy

Public policy—as established by statute, regulation, or judicial decisions—may be considered in determining whether an act or practice is unfair under Section 5 of the FTC Act. For example, a credit card lending practice that violates a federal banking regulation may evidence an unfair act or practice. In Credit Card Lending Consultation #4, a bank failed to provide required finance charge disclosures under Regulation Z (Truth in Lending) yet charged finance charges to a consumer's account. The consultants cited the violation of Regulation Z as evidence of an unfair credit card lending practice.

Credit Card Lending Lesson #4: The consequences of noncompliance with consumer protection laws and regulations are not limited to the statutory and regulatory penalties specific to those laws. In Credit Card Lending Consultation #4, a bank's violation of Regulation Z was found to evidence conduct contrary to public policy and, thus, was considered in analyzing unfairness under Section 5 of the FTC Act. Therefore, a comprehensive and effective compliance management program—one that avoids an overly myopic and, thus, constrained approach to compliance—will greatly benefit a bank in general, and in particular with respect to compliance with Section 5 of the FTC Act.

[22] The Federal Reserve Board (FRB) has proposed amendments to Regulation AA which, if adopted, would restrict the allocation of credit card payments in excess of the required minimum payment. The proposal provides that when different annual percentage rates (APRs) apply to different balances on a credit card account (for example, purchases and cash advances), banks would have to allocate payments exceeding the minimum payment using one of three methods or a method equally beneficial to consumers. They could not allocate the entire amount (i.e., the amount in excess of the required minimum payment) to the balance with the lowest rate. Under the proposal, a bank could, for example, split the amount equally between two balances. In addition, to enable consumers to receive the full benefit of discounted promotional rates (for example, on balance transfers) during the promotional period, payments in excess of the minimum would have to be allocated first to balances on which the rate is not discounted.

The FRB has indicated it expects to issue a final rule by the end of 2008. However, as of the date of publication of this article, the FRB has not done so. When issued, the reader is urged to consult amended Regulation AA for UDAP guidance with respect to credit card payment allocation practices as well practices relating to time to make payments, application of an increased annual percentage rate to outstanding balances, fees for exceeding the credit limit caused by credit holds, security deposits and fees for the issuance or availability of credit, and use of unfair balance computation methods (as well as overdraft protection practices). In addition to Regulation AA, Regulation Z (Section 226), implementing the Truth in Lending Act (as recently amended by the Home Ownership and Equity Protection Act Amendments of 2008), proscribes several specific mortgage lending acts and practices as unfair or deceptive, including certain servicing and advertising practices and the coercion of appraisers. In limited circumstances, Regulation Z also prohibits as unfair collateral-based lending, stated-income/asset-based lending, prepayment penalties, and not escrowing for taxes and insurance. All other practices must be judged by applying the FTC Act UDAP standards discussed in this article.

[23] FIL-6-2007, "FDIC Supervisory Policy on Predatory Lending" (January 22, 2007, p. 1), www.fdic.gov/news/news/financial/2007/fil07006.html.

Conclusion

Meeting the standards for deception or unfairness depends on the specific facts and circumstances of each case. Judgment will always be a factor. The FDIC examination-consultation process assists FDIC staff responsible for exercising such judgment. Through the consultation process, not only are concerns relevant to a particular examination appropriately and comprehensively addressed, valuable lessons emerge that can assist in future examinations and serve as the basis for effective supervisory policy.

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