

**The Current Crisis in Subprime Lending -  
Is a Regulation on Unfair and Deceptive Acts or Practices the Answer?  
OTS issues ANPR**

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In the past few months there has been much discussion on what could have been done differently or whether additional regulation of banks and thrifts could have prevented the current subprime lending meltdown. There are suggestions that the federal banking regulators could have taken actions that would have mitigated, if not prevented, the problems that have surfaced.

In response to the calls from Congress and others, the Office of Thrift Supervision (“OTS”) has issued an advance notice of rulemaking to implement its authority under the Federal Trade Commission Act (“FTC Act”) in the area of Unfair or Deceptive Acts or Practices. While any rule issued by the OTS would apply only to savings associations and possibly their affiliates, the issues raised in the advanced notice are instructive and provide a useful guide to some of the factors that need to be addressed in this area.

The OTS has authority under Section 5 of the FTC Act to issue regulations for savings associations to implement the requirement that unfair and deceptive acts or practices be prevented. The agency also asserts its authority to ensure the safe and sound operation of savings associations under the Home Owners’ Loan Act (“HOLA”) in the ANPR. The Federal Reserve and the NCUA have similar authority for their constituencies. The OTS had issued a regulation in the mid 1980’s that addresses credit practices in the consumer lending area but these regulations have not been updated and do not address mortgage lending. This rule is similar to Regulation AA issued by the Federal Reserve.

The OTS’s 1985 Credit Practices regulation describes a number of practices that, if they are engaged in by savings associations, are per se violations unfair or deceptive acts or practices within the meaning of Section 5 of the FTC Act. The current regulation addresses the extension of credit to consumers for the acquisition of goods, services, or money for household or personal purposes.

The provisions of these regulations are relatively narrow and do not address the issues that arise in the context of mortgage lending or servicing. In addition, the current regulation does not permit the agency to take the circumstances of any of the parties or the practices into account. Any rule might include the terms of this regulation with an updated or more flexible approach. If a principles based approach is adopted, the less specific provisions of the current regulation could be adapted to be included in any final rule.

The advance notice poses a number of questions about the possible approaches that the agency may take, including whether the agency should consider a further rulemaking in unfair acts or practices that would cover products and services in addition to consumer credit. The possible approaches include developing a rule that follows the policy and guidance of the FTC model.

Rather than issue regulations establishing definitions for unfair or deceptive acts or practices, the FTC (or the “Commission”) has issued Policy Statements on unfairness and deception that describe the framework the agency uses to determine whether companies or persons are engaging in unfair or deceptive acts or practices. The Commission decided that because the situations are fact specific and do not lend themselves to a regulatory approach, it should issue guidance that describes the factors that it will consider when making an evaluation of unfairness or deception.

The Policy Statements were developed after a review of the decided cases and other decisions and provide the general principles of applicability considered by the Commission. In issuing the statements, the FTC also provides an indication of how it will enforce the standards. The Policy Statements were issued in the 1980’s and have not been amended, but the principles included are the basis of the enforcement actions and cases brought since their issuance. In each case, the statements establish a framework to determine unfairness and deception in every context and for every industry, not just financial services.

### **FTC Policy Statement on Unfairness**

The FTC Policy Statement on Unfairness was issued on December 17, 1980. The Policy Statement describes how the Commission examines and enforces unfairness and deception and how the concepts are different. The Policy Statement explains that the FTC Act was drafted to include a general standard rather than a list of unfair trade practices that would easily become out of date or which would be easy for companies to evade. The statute provides that the FTC identify unfair trade practices, subject to judicial review. Early on, three factors were identified that the Commission considers: whether the practice injures consumers, whether it violates established public policy, and whether it is unethical or unscrupulous.

As time went on, the factors have been refined. For example, in order to justify a finding of unfairness, the injury to the consumer must satisfy three tests: it must be substantial; it must be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not have reasonably avoided.

For an injury to be substantial in most cases there has to be monetary harm, however, unwarranted health and safety risks may also support a finding of unfairness. Other more subjective forms of harm, for example emotional impact, likely will not produce a finding of unfairness. In determining whether the injury or harm is outweighed by any offsetting consumer or competitive benefits, the FTC also looks at the costs of the remedy. Finally, the injury must be one that cannot be avoided by consumers. The FTC recognizes that certain types of sales techniques may effectively prevent consumers from making their own choices and the market place is not self correcting in those circumstances.

### **FTC Policy Statement on Deception**

The Policy Statement on Deception was issued on October 14, 1983 and establishes the elements that are found in the deception cases brought by the Commission. There must be a representation, omission or practice that is likely to mislead the consumer. Further the FTC

examines the practice from the perspective of a consumer acting reasonably in the circumstances. Finally, the representation, omission or practice must be material.

The question that the FTC asks is whether the act or practice is likely to affect the consumer's conduct or decision with regard to a product or service. If it has, the practice is material and consumer injury is likely. Put another way, the consumer would have chosen differently but for the deception. The FTC will find deception if there is a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances to the consumer's detriment.

### **The Banking Agencies Adoption of the FTC Principles**

The FDIC, Federal Reserve and the OCC have each adopted the principles for determining unfairness or deception. In addition to using unfair or deceptive acts or practices as a basis for enforcement actions, the FDIC and the Federal Reserve issued guidance on March 11, 2004 that outlines the standards that the two agencies would consider to enforce their obligations under Section 5 of the FTC Act. This guidance is applicable to the acts and practices of state chartered banks. The guidance includes a discussion of the management of risks relating to unfair or deceptive acts or practices. The agencies believe the risk management techniques can be seen as best practices as well as general guidance.

The OCC issued regulations in January 2004 that specifically included provisions prohibiting national banks from engaging in unfair or deceptive within the meaning of Section 5 of the FTC Act. The agency had previously issued advisory letters addressing abusive or predatory lending practices and later issued guidance that establishes standards for residential mortgage lending practices that specifically refer to the FTC principles.

Further, each of the federal banking agencies, including the OTS, has authority under section 8 of the Federal Deposit Insurance Act ("FDIA") to bring an enforcement action against an insured depository that it finds is operating in an unsafe and unsound condition. A finding that the institution is offering product and services in an unfair or deceptive manner would be considered an unsafe and unsound action.

### **Example of FTC Enforcement**

The OTS poses a question about whether the enforcement actions brought by the FTC can be used as examples of the elements that might be included in any final rule. Under the FTC Act, the FTC has enforcement authority over non depository lenders and other companies that originate and service mortgages and other loans, including credit card loans. In the enforcement context, the FTC has used a principles based approach to bring cases against companies that it believes or suspects may have engaged in unfair or deceptive acts or practices. In the enforcement actions, the acts and practices are specifically described. Many of the actions have been brought against servicers or consumer finance companies. Of note is that on the FTC website, there is a list of 21 cases brought against subprime lenders since 1998. Not all of them address servicing but a noteworthy example is the Fairbanks settlement.

In the 2003 Fairbanks settlement, the FTC and HUD defined the practices in the servicing area that they believed were unfair and deceptive. The practices highlighted included:

- failing to post consumer's mortgage payments in a timely and proper manner, and then charging consumers late fees or additional interest for failing to make their payments on time;
- charging consumers for placing casualty insurance on their loans when insurance was already in place;
- assessing and collecting improper or unwarranted fees, such as late fees, delinquency fees, attorney's fees or other fees and misrepresenting the amounts that consumers owed.

In the Fairbanks settlement, the FTC and HUD also found that the company had violated a number of other consumer protection statutes and as part of the settlement required remedial actions. The settlement provides what might be considered to be best practices for servicers.

In an enforcement action brought by the OTS, the agency used its authority under the HOLA and Section 8 of the FDIA to address similar servicing issues. The OTS entered a Written Supervisory Agreement with Ocwen Federal Bank FSB on April 19, 2004 that identified a number of servicing and consumer complaint issues that the institution was required to address with a systematic compliance plan.

While the FTC's enforcement actions and settlement documents are a useful roadmap to behaviors of which savings associations should be aware, the agreements are fact specific and include a list of the actions or practices that the Commission has found to be unfair or deceptive in connection with the particular company. Given the fact specific nature of the settlement agreements such examples cannot be seen as the only acts or practices that are found to violate the established principles or the statute. By including the specific practices found in the enforcement documents, the OTS would limit itself in the activities or practices that it might find to be unfair or deceptive.

### **Questions in ANPR**

The agency also solicits input on whether existing guidance should be converted into rules or whether a principles based approach should be used. The agencies, including the OTS, have issued guidance on a number of consumer protection topics, including nontraditional mortgage products, overdraft protection products, and gift card programs. The OTS suggests that it may look to other agencies for examples of how to develop a model. The advance notice refers to the guidelines for residential mortgage lending practices adopted by the OCC. These guidelines mention specific lending practices that the agency finds are predatory or abusive. The advance notice also provides an example of state law models that have been developed and used a more targeted approach.

A targeted approach would list acts or practices regarding specific products. For example in the area of credit cards, residential lending, deposit accounts and gift cards, practices that the OTS finds to be unfair or deceptive would be prohibited.

This ANPR may result in a proposal for savings association or the other agencies may follow the lead of the OTS and/or the agencies may decide to engage in joint rulemaking. Another alternative is that Congress will take action. The ANPR is useful in identifying the issues.