Federal Trade Commission Act, Section 5 Unfair or Deceptive Acts or Practices[1]

Introduction

Advances in banking technology and changes in lending organization structure since Gramm-Leach-Bliley have permitted banks to engage in non-banking activities and given banking organizations the ability to structure financial products in increasingly complex ways and to market such products with increasingly sophisticated methods. While most banking organizations do not engage in unfair or deceptive acts or practices, the pace and complexity of these advances heighten the potential risk for consumer harm. This potential risk, coupled with identified abusive practices, warrants increased scrutiny by the FDIC and state and federal enforcement agencies. Unfair and deceptive practices are wrong, undermine consumer confidence, and present significant credit and asset quality risk undermining the financial soundness of banking organizations.

Section 5 of the Federal Trade Commission Act (FTC Act) declares that unfair or deceptive trade practices are illegal. ***See*** 15 USC §45(a) (FTC Act Section 5). The FDIC confirmed its intent to cite state nonmember banks and their institution-affiliated parties for violations of FTC Act Section 5 and will take appropriate action pursuant to its authority under Section 8 of the Federal Deposit Insurance Act (FDI Act) when unfair or deceptive trade practices are discovered.[2] FDIC enforcement action against entities other than banks will be coordinated with the Federal Trade Commission, which also has authority to take action against nonbank parties that engage in unfair or deceptive trade practices.

On March 11, 2004, the FDIC and the Federal Reserve Board (FRB) issued additional guidance regarding unfair or deceptive acts or practices prohibited by section 5 of the FTC Act.[3] The guidance explains:

- the standards used to assess whether an act or practice is unfair or deceptive;
- the interplay between the FTC Act and other consumer protection statutes; and
- guidelines for managing risks related to unfair and deceptive practices.

Following the release of the UDAP guidance, the FDIC issued a revised consultation policy which requires examiners to consult with the Regional and Washington Offices whenever an apparent unfair or deceptive act or practice is found.

Standards for Determining What is Unfair or Deceptive

The legal standards for unfairness and deception are independent of each other. Depending on the facts, a practice may be unfair, deceptive, or both.

In order to determine whether a practice is "unfair," the FDIC will consider whether the practice "causes or is likely to cause substantial injury to consumers which is not reasonably avoided by consumers themselves and not outweighed by countervailing benefits to consumers or to competition", ***see*** 15 USC §45(n). By adhering to this tenet, the FDIC will take action to address conduct that falls well below the high standards of business practice expected of banks and the parties affiliated with them.

To correct deceptive trade practices, the FDIC will take action against representations, omissions, or practices that are likely to mislead consumers acting reasonably under the circumstances, and are likely to cause such consumers harm. The FDIC will focus on material misrepresentations, i.e., those that affect choices made by consumers because such misrepresentations are most likely to cause consumers financial harm. ***See*** FTC Policy Statement on Deception (October 14, 1983).

Unfair or deceptive acts or practices that violate the FTC Act may also violate other federal or state laws. These include the Truth-in-Lending and Truth-in-Savings Acts, the Equal Credit Opportunity and Fair Housing Acts, and the Fair Debt Collection Practices Act. On the other hand, certain practices may comply fully with consumer protection or other laws and yet still violate the FTC Act. Examiners should consider both possibilities.

Unfair Acts or Practices

Standards for assessing whether an act or practice is unfair

An act or practice is unfair where it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Public policy may also be considered in the analysis of whether a particular act or practice is unfair. Each of these elements is discussed further below.

1 This section fully incorporates the examination procedures issued under DSC RD Memo 05-021: Procedures for Determining Compliance with the Prohibition on Unfair or Deceptive Acts or Practices Found in Section 5 of the FTC Act.

2 *See* FIL 57-2002

3 *See* FIL 26-2004

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

  To be unfair, an act or practice must cause or be likely to cause substantial injury to consumers. Substantial injury usually involves monetary harm. An act or practice that causes a small amount of harm to a large number of people may be deemed to cause substantial injury. An injury may be substantial if it raises a significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair.

- ***Consumers must not reasonably be able to avoid the injury.***

  A practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions. Withholding material price information until after the consumer has committed to purchase the product or service would be an example of preventing a consumer from making an informed decision. A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

  The FDIC will not second-guess the wisdom of particular consumer decisions. Instead, the FDIC will consider whether a bank's behavior unreasonably creates or takes advantage of an obstacle to the free exercise of consumer decision-making.

- ***The injury must not be outweighed by countervailing benefits to consumers or to competition.***

  To be unfair, the act or practice must be injurious in its net effects —that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting benefits may include lower prices or a wider availability of products and services.

  Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the bank in taking preventive measures and the costs to society as a whole of any increased burden and similar matters.

- ***Public policy may be considered.***

  Public policy, as established by statute, regulation, or judicial decisions may be considered with all other evidence in determining whether an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is affirmatively allowed by statute may be considered as evidence that the practice is not unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair.

Deceptive Acts and Practices

Standards for assessing whether an act or practice is deceptive

A three-part test is used to determine whether a representation, omission, or practice is "deceptive." First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Lastly, the misleading representation, omission, or practice must be material. Each of these elements is discussed below in greater detail.

- ***There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.***

  An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead the consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is likely to mislead consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled.

  In determining whether an individual statement, representation, or omission is misleading, the statement, representation, or omission will not be evaluated in isolation. The FDIC will evaluate it in the context of the entire advertisement, transaction, or course of dealing to determine whether it constitutes deception. Acts or practices that have the potential to be deceptive include: making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not in fact available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.

- ***The act or practice must be considered from the perspective of the reasonable consumer.***

  In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. The test is whether the consumer's expectations or interpretation are reasonable in light of the claims made. When representations or marketing practices