One year after its foundation, the Consumer Financial Protection Bureau (CFPB) issued its first enforcement action in late last month, and more look set to follow.

The first case was against Capital One over its “deceptive” card marketing-related activities. These practices, the agency said, misled credit card users with low credit scores or limits through a variety of “add-ons” such as credit-monitoring and payment-protection services about the benefits, costs and nature of products, as well as the eligibility of customers.

The bureau is expected to follow up with at least two more enforcement actions, one against American Express and the other Discover Financial Services over similar issues. Although the actions may help the bureau define its role of protecting consumers from being intentionally misled, the bureau also risks providing the banks with a moving regulatory yardstick due to its lingering lack of a clear definition regarding “abusive” practices.

Following the enactment of the Dodd-Frank Act in the wake of the financial crisis, CFPB was created in accordance with the Act's Title X. It is based on the model of the Consumer Product Safety Commission, equipped with a consumer hotline and a public database to track some 42,000 consumer complaints or concerns. Its principal objective is to supervise and examine the depository institutions with more than $10 billion in assets, nonbank covered persons in residential mortgage, private education lending and payday lending markets, as well as “larger participants” of markets for other consumer financial products.

The bureau is expected, furthermore, to enhance consumer financial literacy, to unify supervision and enforcement of existing protection laws on consumer finance (such as Truth in Lending, Equal Credit Opportunity, Truth in Savings), to conduct market research and to protect consumers against “unfair, deceptive and abusive acts or practices” (UDAAP) with particular emphasis on consumer products such as mortgages, credit cards and student loans.

CFPB, therefore, becomes a one-stop shop for all the consumer products or services (except for the auto and insurance industries) through the inheritance of the “alphabet soup” of regulations on consumer finance, and a focal agent for streamlining what previously used to be a patchwork of more than 11 different agencies’ conflicting and secondary mandates of consumer protection.
Previously, the Federal Trade Commission (FTC) was the only agency having consumer finance as its primary focus, yet it had traditionally been limited to anti-competitive practices. The CFPB’s creation will also have the added benefit of avoiding “regulatory shopping” by financial firms through a simple change of forms.

In its short life-span so far, particularly in view of the fact that it operated without a director for its first six months, the CFPB has made great strides in achieving a number of its designated objectives.

It has finalized eight rules, two of which are especially critical for the consumer finance industry. In the first of what the bureau intends to be a series of rules, it started defining “larger participants”, that is, the identification of significant nonbank participants in the consumer finance business.

It also passed a rule on supervising (as well as writing rules and enforcing them) 30 large consumer reporting agencies (also known as credit reporting companies) that cover 94 percent of the market. The latter rule will be critical for the financial services market as these agencies determine through their reports the eligibility and rates for credit for more than 200 million American consumers. The bureau has, furthermore, organized three public field hearings, and produced a number of studies on issues such as fair debt collection practices, reverse mortgages, and private student loans.

Perhaps most notably, the Bureau has shown that it is not solely after making a showcase of violations. After all, it has not required Capital One to admit wrongdoing publicly. Instead, its intention has been to focus on establishing norms and convincing supervised institutions it wants to help them become more “consumer friendly”. To this effect, the Bureau has accompanied its first enforcement action with a compliance bulletin, providing further guidance on the marketing of consumer financial products for similar institutions.

Nevertheless, the bureau has faced criticism due to a lack of definitions surrounding the three “UDAAP” terms (unfair, deceptive, and abusive practices) on which it bases its enforcement actions.

“The terms ‘unfair’ and ‘deceptive’ are open to interpretation. Banks prefer looking for hard and fast rules rather than post-facto judgment and qualitative rules to follow,” said Joseph Lynyak, a partner with Pillsbury Law, in an interview, referring to the Bureau’s enforcement action against Capital One.

Other experts differed. “While open to a certain level of interpretation, the guidance on ‘unfair’ and ‘deceptive’ practices should be clear enough for the institutions,” said Vicki Morwitz, a professor at the New York University Stern School of Business.

Said Amy Friend, a Managing Director at Promontory Financial Group, also a former Chief Counsel to the Senate Committee on Banking, “‘Unfair’ and ‘deceptive’ are well litigated and defined terms as a result of having been in the FTC
Act for many years."

Instead, she emphasized that the bigger challenge is the term “abusive.” “The term ‘abusive’ is something that hasn’t been interpreted before, other than in the statute itself, and that is where I would anticipate a great deal of uncertainty.”

Unlike its older counterparts of “unfair” and “deceptive”, which featured in section 5 of Federal Trade Commission Act, the word “abusive” has been introduced into the legislative area only recently through Dodd-Frank and has no precedent in usage, leaving the Bureau unable to draw examples from practical cases.

Furthermore, Director Cordray of CFPB has shied away from publicly laying out a formal definition, most recently at a congressional panel on July 24. It is conceptually difficult to imagine a practice being abusive yet not being unfair or deceptive at the same time. Perhaps for this reason, the Bureau has no distinct examples of abusive acts or practices as it does for unfair or deceptive practices within its guidelines. Therefore, the term may have little, if any, independent significance.

Additionally, the bureau has to strike the right balance in defining other terms, such as “qualified residential mortgage” and its related “safe harbor” clause, both of which are affected by the UDAAP. Too much restriction, for instance, for the safe harbor clause may force the banks to shy away from utilizing certain products, or reduce the availability of credit in the market. And, too broad of a definition may create a pre-2007 environment where the clause may become a dangerous loophole.

The term “abusive” has not been used by the bureau against Capital One. However, unless defined with due consideration for clarity and balance, such new terms may lead to confusion for the regulated institutions. Whether such terms will open a can of worms by forming a basis for enforcement actions in the future or merely alter the label on the can and fall into disuse remains to be seen.

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