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Banker Beware: Bank Practices under Increased Scrutiny as Dodd-Frank Implementation Begins

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A new wave of consumer banking litigation and regulatory activity is anticipated as financial institutions introduce new products and increase fees to offset costs and lost revenue attributable to the Dodd-Frank Act. Several major banks have recently settled class action lawsuits for allegedly processing transactions from higher to lowest amount to maximize customer overdraft revenues, and class action attorneys are expected to use these cases as models for future litigation. Banking regulators have also increasingly shown a willingness to take on practices deemed unfair or deceptive to consumers, even if the practices are not prohibited by a particular law. This is a call for financial institutions to proactively review marketing materials, account agreements, and disclosures documents, and to ensure that new products and fees are not targeted at unsophisticated consumers.

In California, private litigants challenging banking operations typically rely on the Unfair Business Practices Act, which prohibits practices that are unlawful, unfair or fraudulent, in addition to common law and false advertising claims. These plaintiffs enjoy a relaxed burden of proof in many respects. For example, under California Business and Professions Code section 17200, to establish that a business practice was fraudulent, plaintiffs need only show that the practice is deceptive based on the likely effect it would have on a hypothetical "reasonable consumer."

In *Gutierrez v. Wells Fargo Bank*,[1] a federal judge applied California law in the action, which challenged the propriety of posting transactions from the highest to the lowest dollar amounts on the ground that this increased overdraft fees. The court found the bank's marketing materials to be misleading, mostly based on statements contained in the bank's new account welcome jacket and in glossy brochures. Disclosures made in the consumer account agreement and in fee schedules (held in pockets inside the new account jacket) were in many instances dismissed as irrelevant by the court, because consumers could not be expected to read the lengthy document, and, even if read, the disclosures were difficult for consumers to understand.

The *Gutierrez* court also concluded that high-to-low sequencing was "a trap" intended to rack up fees "off the backs of the working poor, students, and others without the luxury of ample account balances." Restitution of over $200 million was ordered, in addition to other relief. The case is on appeal before the Ninth Circuit.

Operational practices are receiving increased regulatory scrutiny as well. Presently, federal banking agencies have broad authority under Section 5 of the Federal Trade Commission Act to address banking practices deemed unfair or deceptive to consumers. The Dodd-Frank Act expands regulatory authority in this area by prohibiting "abusive" acts, in addition to unfair and deceptive practices. What constitutes an "abusive" practice remains to be seen; but this rule gives banking regulators even broader powers to address new products and new fee structures.

Like the class action plaintiffs' attorneys, banking regulators are likely to pay closest attention to new products that target lower income consumers and fee structures that most heavily impact customers with low account balances. In 2010, the FDIC issued overdraft program guidance, which became applicable after July 21, 2011. And in 2011, the Office of the Comptroller of the Currency issued proposed guidance similar to the FDIC's. Through this process, the regulators have informed the institutions of their expectation that each bank will actively contact and counsel customers who make excessive use of overdraft programs and limit overdraft fees.

Deposit-related consumer credit products have received similar scrutiny from regulators. These products, which some argue are the equivalent of a traditional payday loan, extend relatively small amounts of credit at a fee of up to 10 percent of the amount borrowed, although the loan typically comes due in 35 days and is repaid from incoming direct deposits. Recently proposed OCC guidance requires national banks and federal thrifts to provide customers with clear and conspicuous disclosures, implement limitations on product use, and monitor customer usage and product revenue.

A new regulatory agency, the Bureau of Consumer Financial Protection, was created by the Dodd-Frank Act. The Bureau, which is nominally part of the Federal Reserve, will have authority to write new standards for a wide array of financial products as well as authority to enforce federal consumer financial protection laws. Although the rule-making process has just begun, when asked about a $5 debit card service fee imposed by a national bank to replace revenue lost due to the

interchange rate cap imposed by Dodd-Frank, President Obama stated to ABC News, “This is exactly why we need this Consumer Finance Protection Bureau.”

It remains to be seen whether the Bureau deems the lawful imposition of debit card fees to be an “abusive” practice. But recent regulatory guidance and judicial rulings should be a wake-up call for all financial institutions to actively review their marketing materials, account agreements, and fee schedules to ensure that customers are fully informed of the fees that they may be charged. The need for caution is particularly acute for products that are frequently used by unsophisticated consumers, such as overdraft protection and direct-deposit advance programs.

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1 United States District Court for the Northern District of California Case No. 3:07-CV-05932-WHA