



The Abuse of ‘Abusive’?*

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June, 2011

The safe harbor practice of providing “clear and conspicuous disclosure” of the terms and conditions of a service or product may no longer be sufficient to protect creditors from charges of committing unlawful abusive acts or practices. Since the enactment of Sec. 1031 of the Dodd-Frank Act, compliance officers and regulatory attorneys have been worrying about what the new consumer protection standard of “abusive acts and practices” will be and how to protect their institutions and clients from litigation and enforcement actions. It appears that a financial service or product could be declared “abusive” even though it was not unfair or deceptive, since the new standard is now “unfair, deceptive or abusive acts or practices.”¹ A short article in the May issue of Kiplinger’s Personal Finance now adds another potential compliance challenge.

“The Boomer Brain Fade” by Robert Frick addresses the limitations of disclosures for consumers as they age.² The article describes a research paper authored by Sumit Agarwal, an economist with the Federal Reserve Bank of Chicago, “The Age of Reason: Financial Decisions Over the Life-Cycle with Implications for Regulation.”³ Mr. Agarwal posed some simple financial word problems to consumers. For example, he asked the following question: “Five of you go in on an equal shares lottery ticket, and the ticket is a winner for a \$2 million prize. How much will you get?” Quick, what’s your answer? If you answered that your share is \$400,000, you did better than half of the 50 year-old consumers who participated in his test, better than 75 percent of the 85 year-olds and almost 100 percent of 90 year-olds.⁴ Robert Frick

*The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

¹P.L. 111-203, Sec. 1031.

²Robert Frick, “Your Mind and Your Money — The Boomer Brain Fade,” Kiplinger’s Personal Finance, May 2011, p. 24.

³Brookings Papers on Economic Activity, Fall 2009. Pp. 51-117.

⁴Section 1032 of the Dodd-Frank Act allows the Bureau to require that the financial products’ and services’ features are “fully, accurately, and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits, and risks

notes that Mr. Agarwal and his co-authors conclude that better disclosure makes surprisingly little difference as consumers age. Robert Frick then recommends that we admit our declining abilities, get a pension or buy an annuity (to reduce the complexity of further economic decisions), and/or designate a financial advisor or family member you trust to handle financial decisions. What does this research mean for the Bureau?

Arguably, the Bureau could conclude that some financial services and products are abusive for the elderly or the financially illiterate because the services and products simply cannot be understood by them. Such a result is supported by the language of Sec. 1031(d) of the Dodd-Frank Act, which reads as follows:

- (d) ABUSIVE.—The Bureau shall have no authority under this section to declare an act or practice abusive in connection with the provision of a consumer financial product or service, unless the act or practice—
 - (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service; or
 - (2) **takes unreasonable advantage of—**
 - (A) **a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;**
 - (B) **the inability of the consumer to protect the interests of the consumer in selecting or using a consumer financial product or service; or**
 - (C) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer. [*Emphasis added.*]

Of particular interest in Mr. Agarwal’s paper is a discussion of possible regulatory responses to this research. Those responses range from “laissez faire” to “mandatory explicit regulatory approval.” Robert Frick’s recommendations (see above) would fall into the “laissez faire” category, which the Age of Reason paper says is limited by seven factors:

associated with the product or service, in light of the facts and circumstances.”

- (1) the failure to anticipate, when cognitively healthy, the possibility of one's own future cognitive decline;
- (2) the mistaken belief that one will recognize one's own cognitive decline and respond optimally by progressively delegating decision-making as it occurs;
- (3) procrastination;
- (4) the difficulties that external parties face in determining when key thresholds of cognitive decline have been crossed, so that control can be transferred efficiently;
- (5) administrative costs, particularly when the trustee is a third party such as an attorney;
- (6) a lack of financially sophisticated family members, capable of making good financial decisions on the declining adult's behalf; and
- (7) a lack of trustworthy family members.

As for the use of full and fair disclosure, Mr. Agarwal and his co-authors write: "However, we are skeptical that improved disclosure will be effective in improving financial choices. Even for cognitively healthy populations, there is scant evidence that increases in disclosure improve decision-making."

Other regulatory approaches include requiring individuals to obtain a financial license before they may buy a product or service other than a very simple financial product; imposing a fiduciary duty on all sellers of financial products; requiring a financial advisor for financial transactions as buyers age; imposing a mandatory safe harbor for investments based upon a percentage of an individual's income and assets; default regulatory approval with close monitoring as we do with dietary supplements; and mandatory explicit regulatory approval for products and services aimed at the older consumers. Since the Bureau has no power to require a consumer to take a particular action, the options of a financial driver's license or a mandatory asset allocation are not feasible. On the other hand, based upon this research, the Bureau could pursue default regulatory approval, and mandatory explicit regulatory approval for certain products and services directed to older consumers. Whether or not they do so remains to be seen.

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