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Understanding and Applying Dodd-Frank's 'Abusive' Standard

By Eric Mogilnicki and Eamonn K. Moran

Introduction

One of the many innovations in the Dodd-Frank Act was the inclusion of a prohibition on ''abusive'' conduct. This new standard provided the Consumer Financial Protection Bureau (the ''Bureau'' or ''CFPB'') with a new enforcement tool, but little guidance on what conduct it proscribed. This lack of clarity has gotten worse — not better — over the past four years.

This lack of clarity is poor public policy. Consumers may not be receiving the full benefit of the new legal regime; financial institutions are not on fair notice of what conduct may violate the law; the Bureau cannot be certain of applying the same standards across cases; and Congress is not able to review – and revise, if needed – the Bureau's interpretation of the new standard.

In the interests of clarity, the Bureau should consider proposing rules that provide guidance to financial institutions seeking to avoid engaging in abusive conduct. This could include invoking the Bureau's ''abusive'' standard, when appropriate, in Bureau rulemakings to prohibit certain acts or practices in connection with the offering or provision of particular consumer financial products and services. Such an approach would help flesh out the meaning of the ''abusive'' standard without requiring a full and final definition. In any event, the process of soliciting input on rules that describe ''abusive'' conduct would provide the Bureau with a rounded perspective that could inform its interpretation of the new standard. At present, the Bureau is interpreting the standard in examination and enforcement matters that are shaped by only the Bureau and the affected entity. [1]

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This article seeks to begin a broader conversation by elaborating on the ''abusive'' standard in light of the logic and language of the statutory text and the intentions of its framers. Our analysis indicates that the new standard tracks what ''abusive'' means in common discourse: that the relationship between two parties involves an imbalance that is being exploited by the stronger party. In a second article, we will review the ''abusive'' cases brought to date by the CFPB, and analyze whether these enforcement matters provide adequate guidance to financial institutions seeking to avoid ''abusive'' acts or practices.

The Abusive Standard

The ''abusive'' standard, as set forth at 12 U.S.C. 5531 prohibits four types of conduct as ''abusive:''

(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] Director Cordray has resisted suggestions from Members of Congress and others that the Bureau adopt a regulation on this subject, explaining that Congress has already provided a definition of ''abusive.'' *See* Transcript of *The Semi-Annual Report of the Consumer Financial Protection Bureau*, Hearing of the House Financial Services Committee Hearing, March 29, 2012 at 15. Of course, Congress also provided the Bureau the authority to issue UDAAP regulations. *See* 12 U.S.C. § 5531(b). At a minimum, the Bureau could issue a Bulletin providing guidance on this important subject. *See, e.g.*, CFPB Bulletin 2013-07 (providing examples of potential UDAAP violations in debt collection).

(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.

These provisions are all variations on a theme. Each of these four types of ''abuse'' involves: (1) an imbalance in the relationship between a covered person and a consumer; and (2) exploitation of that imbalance by the covered person. An imbalance in a relationship occurs when the covered person interferes with the consumer's ability to understand a transaction, 12 U.S.C. § 5531(d)(1), or when the covered person has superior power, 12 U.S.C. § 5531(d)(2)(B) or superior information, 12 U.S.C. § 5531(d)(2)(A) – including a superior understanding of the fact that the consumer should not rely on the covered person to act in the consumer's interests, 12 U.S.C. § 5531(d)(2)(C). Exploitation of that imbalance occurs when the covered person uses his or her superior understanding, power, or information to secure a transaction with terms that are so unreasonable that they can be explained only by the consumer's lack of understanding, power or information.

Such attention should include efforts to educate them, to make financial products and services understandable, and to ensure that the products and services sold by the financial institution are valuable to consumers and so defensible as rationally chosen by consumers.

To be sure, this elaboration eliminates only a portion of the grey area left by the statutory language itself. But it does provide a fuller understanding of ''abusive,'' and a guide for assessing whether the Bureau's early ''abusive'' cases offer a consistent, coherent approach to the new standard. For example, the analysis set forth above makes clearer that a particular product or service cannot be ''abusive'' in a vacuum. Nor does a particular imbalance – even one between a powerful financial institution and a low-information consumer – create an ''abusive'' situation standing alone. Instead, a finding of abusiveness requires findings about how that relationship led to a particular transaction that caused consumer harm.

This focus on the relationship between the parties means that financial institutions should pay special attention to vulnerable consumers, including the poor, the elderly, and servicemembers. Such attention should include efforts to educate them, to make financial products and services understandable, and to ensure that the products and services sold by the financial institution are valuable to consumers and so defensible as rationally chosen by consumers.

At the same time, this focus on relationships provides some limitations to what the Bureau may deem ''abusive.'' The Bureau cannot merely substitute its judgment for the consumer's judgment, nor make broad assumptions about what consumers want or understand. Instead, the Bureau must demonstrate that the consumer lacked power or information *and* that the transaction reflects that lack of power or information.

The Bureau's burden will be difficult to meet on a wholesale basis. To be sure, the Bureau may demonstrate that a large group of consumers were victims of ''abusive'' practices when, for example, a covered person hides information from consumers that would have stopped any rational consumer from entering into the transaction. However, when the relevant information was available and/or some consumers might have entered into the transaction notwithstanding that information, the ''abusive'' standard will be met only when the Bureau can isolate those consumers who lacked understanding, information, or power *and* for whom the product was useless.

This article proceeds in two parts. The first elaborates on the foregoing analysis and grounds it in the text and legislative history of the ''abusive'' standard. The second analyzes the CFPB's public enforcement cases to date to see if they illuminate the Bureau's interpretation of the ''abusive'' standard. Unfortunately, this analysis suggests that the Bureau has not yet rationalized its approach to the ''abusive'' standard.

The Origins of the ''Abusive'' Standard

The Obama Administration first proposed a UDAAP standard in a June 2009 Department of the Treasury whitepaper outlining the Administration's financial regulatory reform proposal.[2] In that whitepaper, the Obama Administration also set forth its proposal for a ''new Consumer Financial Protection Agency to protect consumers across the financial sector from unfair, deceptive, and abusive practices.''[3] The whitepaper discussed how seemingly ''simple'' financial products such as mortgages and credit cards ''remain complicated to large numbers of Americans.''[4] The whitepaper indirectly linked this difficulty in understanding to the new ''abusive'' standard, noting that ''a number of federal and state regulations were in place to protect consumers against fraud and to promote understanding of financial products like credit cards and mortgages'' prior to the financial crisis, but the then-existing regulatory framework ''proved inadequate'' as abusive practices spread, particularly in the subprime and nontraditional mortgage market.[5]

The whitepaper also noted the spread of ''abusive credit card contracts,'' which, according to the Administration, included unfair contracts and practices and ''perverse and hidden incentives to take advantage of consumers.''[6] The whitepaper did not provide any addi-

[2] Dept. of the Treasury, Financial Regulatory Reform: A New Foundation 1 (June 2009).

[3] *Id.* at 3, 67-68.

[4] / *Id.* at 67.

[5] *Id.* at 7, 55.

[6] *Id.* at 56, 67 (noting how in the credit card market, ''the opacity of increasingly complicated products led major card issuers to migrate almost uniformly to unfavorable methods for

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tional context or guidance to help define an "abusive" act or practice, other than stating that "there must also be standards for appropriate business conduct and regulations that help ensure providers do not have undue incentives to undermine those standards." Despite the fact that "abusive" acts or practices were a new addition to the existing UDAP legal framework in the Federal Trade Commission Act ("FTC Act"), the whitepaper stated that the legal standards for the UDAAP authorities "are generally well-established."

The Senate Banking Committee report accompanying the bill noted only that while current law prohibits unfair or deceptive acts or practice, "[t]he addition of 'abusive' will ensure that the Bureau is empowered to cover practices where providers unreasonably take advantage of consumers."

At a July 8, 2009 House Financial Services Committee hearing, then Chairman Barney Frank (D-Mass.) introduced H.R. 3126 – the Consumer Financial Protection Agency Act of 2009 – establishing what is now known as the CFPB and setting out the UDAAP standard without defining "abusive."[7] This draft bill simply provided that the CFPB may take any action authorized under its enforcement powers "to prevent a person from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service."[8] On Sept. 25, 2009, Chairman Frank introduced "discussion" draft legislation that made a number of key changes from H.R. 3126, including confining the CFPB's authority to take action to prevent an unfair, deceptive or abusive act or practice to the "offering" of a consumer financial product or service (which, as noted above, was previously limited to a transaction). The House in December 2009 passed its version of the comprehensive financial reform bill – now H.R. 4173 – which simultaneously provided additional guidance on what constituted "abusive" acts or practices and limited such acts or practices to those which harmed consumers and would, if widespread, "contribute to instability and greater risk in the market.[9]

The Senate Committee on Banking, Housing, and Urban Affairs held a hearing on July 14, 2009 concerning the Obama Administration's proposal to establish the CFPB. Once again, no definition of "abusive" emerged. While at least one witness submitted testimony providing examples of lending practices he considered to be abusive, the hearing did not generate an in-depth discussion concerning the scope and limits of this new standard.[10] The Senate Banking Committee report accompanying the bill noted only that while current law prohibits unfair or deceptive acts or practice, "[t]he addition of 'abusive' will ensure that the Bureau is empowered to cover practices where providers unreasonably take advantage of consumers."[11]

The Banking Committee record provides little further insight into the "abusive" standard, in part because there were no proposed amendments to the standard at the Committee level. Further, the full Senate eliminated the House's provision requiring systemic risk, and adopted the text that became 12 U.S.C. § 5531 without discussion. This final language focuses entirely on preventing injury to consumers, and does not require any risk to market stability.

Former Sen. Christopher Dodd (D-Conn.), then chairman of the Senate Banking Committee, acknowledged on the Senate floor in May 2010 that "the word 'abusive' does need to be defined," and he discussed either "striking that word or defining it better."[12] According to Dodd, "[d]eceptive and fraudulent cover the ground pretty well, but I thought abusive was a pretty good explanation point. Because it was abusive, in common language."[13] Unfortunately, the issue never came up on the Senate floor again.

Making Sense of the New Standard

Predictably, the new "abusive" standard immediately raised questions. Some of these questions were answered over time by former House Financial Services Committee Chairman Barney Frank. Others have been answered by CFPB Director Richard Cordray.

Subsection (1): Interference with a Consumer's Understanding

One immediate question is whether and how subsection (1) of the "abusive" standard – prohibiting conduct that "materially interferes with the ability of a consumer to understand" – is different from the existing prohibition on "deceptive" conduct. The canons of leg-

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assessing fees and interest that could easily trap a responsible consumer in debt. Competition did not force these methods out, because consumers were not aware of them or could not understand them, and issuers did not find it profitable to offer contract terms that were transparent to consumers.").

[7] H.R. 3126 was consolidated into the more comprehensive financial reform bill (H.R. 4173) which ultimately was passed by the full House in December 2009.

[8] H.R. 3126, Section 131.

[9] H.R. 4173 set the following limits on what conduct could be deemed "abusive:"

3) ABUSIVE ACTS OR PRACTICES—The Director and the Agency may determine that an act or practice is abusive only if the Director finds that—

(A) the act or practice is reasonably likely to result in a consumer's inability to understand the terms and conditions of a financial product or service or to protect their own interests in selecting or using a financial product or service; and

(B) the widespread use of the act or practice is reasonably likely to contribute to instability and greater risk in the financial system.

H.R. 4173 at section 4031 (c) (emphasis added).

[10] *Creating the Consumer Financial Protection Agency: Hearing on H.R. 3126 Before the S. Comm. on Banking, Housing & Urban Affairs*, 111th Cong. (July 14, 2009). Travis B. Plunkett, legislative director for the Consumer Federation of America, described "abusive" lending practices by smaller banks and thrifts. That list centered on issues affecting consumers with low levels of income and information.

[11] S. Rep. No. 111-176, at 172.

[12] Congressional Record (May 6, 2010; page S3311).

[13] *Id.*

islative construction counsel that this addition of ''abusive'' to the UDAP framework has meaning,[14] but ''deception'' is already generally thought to include acts and omissions that prevent consumer understanding.[15]

The clearest indication of the thinking behind the relationship between ''deceptive'' and ''abusive'' conduct was provided by Chairman Barney Frank, who suggested that ''abusive'' extends beyond the boundaries of deception to cover cases where there may not be a misrepresentation or omission, but an overall approach to disclosure that confused the consumer. During a Nov. 2, 2011 hearing of the House Financial Services Subcommittee on Financial Institutions and Consumer Credit reviewing the first 100 days of the Bureau, Frank stated:

Now, as to abusive, let me state that the gentleman from Alabama, no, the fact that consumer couldn't understand it is not in itself a reason to be declared abusive . . . There are things that could be neither unfair nor deceptive that could be abusive and it is not that the consumer didn't understand it. But there are two categories. . . . [I]f not quite deceptive but framed in a way that made it very hard for the consumer to understand and it wasn't the consumer's fault. That . . . materially interferes with the ability to understand the term.[16]

In short, Subsection (1) was designed to reach practices that prevent understanding without rising to the level of ''deception.''

Subsection (2): Unreasonable Advantage

Subsections (2)(A), (B), and (C) all require that the covered person ''take[] unreasonable advantage'' of the consumer. The adjective ''unreasonable'' is revealing, as it suggests that the statute seeks to confine – but not eliminate – a marketplace in which differences in understanding or power can influence the terms of an agreement between two parties.

Read this way, the ''abusive'' standard shares a common heritage with the state law doctrine of unconscionability, which is likewise concerned with abusive agreements.[17] Indeed, the two prong test for unconscionability mirrors the abusive standard.[18] The first prong is procedural unconscionability, by which courts evaluate whether factors such as consumer ignorance, unexplained fine print, hidden terms, overly technical language, and differences in bargaining power served to deprive a party of a meaningful choice.[19] These unconscionability concepts closely track the concepts in subsections 5531 (d)(2)(A), (B) and (C). The second prong is substantive unconscionability, by which courts focus on any terms so excessively oppressive or one-sided that they ''shock the conscience.''[20] Director Cordray has adopted a similar test for the ''abusive'' standard, which he indicated should be directed at people who ''know what they are doing is probably wrong.''[21]

This commonality of approach and purpose suggest that "abusive" may also share some of the limitations of unconscionability.

This commonality of approach and purpose suggest that ''abusive'' may also share some of the limitations of unconscionability. In particular, both concepts appear designed to prevent sharp dealings, but not to eliminate the possibility that a party with more information or more power strikes an advantageous agreement.[22] Furthermore, while unconscionability prevents the enforcement of specific contract terms or contracts; it does not always prevent enforcement of the provisions that are not the source of the unconscionability.[23]

[14] *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (''It is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void or insignificant.' '') (quoting *Duncan v. Walker, 533 U.S. 174 (2001)*.

[15] *See* Federal Trade Commission, Policy Statement on Deception, *available at* http:/www.ftc.gov/public-statements/1983/10/ftc-policy-statement-deception.

[16] House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, ''The Consumer Financial Protection Bureau: The First 100 Days,'' 112th Cong. (Nov. 2, 2011).

[17] *See, e.g., Deutsche Bank Nat'l Trust Co. v. Pevarski*, 932 N.E.2d 887, 896 (Ohio Ct. App. 2010) (noting that ''[t]he purpose of the doctrine of unconscionability is to prevent oppression and unfair surprise.'' (citing J. Calamari & J. Perillo, Contracts (3 Ed. 1987), 406, Section 9-40)); *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) (''[u]nconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.'');

[18] *See, e.g., Matter of State of New York v. Avco Fin. Serv.*, 50 N.Y.2d 383, 390 (N.Y. 1980); *see also* 8 Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contracts*, § 18:10 (4th. ed. 2010).

[19] *Id.*

[20] *Id.*

[21] House Financial Services Committee, ''The Semi-Annual Report of the Consumer Financial Protection Bureau,'' Testimony of CFPB Director Cordray, 112th Cong. (March 29, 2012), at 27.

[22] *See* 8 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts, § 18:8 (4th. ed. 2010) (''The principle [of unconscionability] is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.''); *Id.* § 18:15 (''The mere assertion that the price was excessive has thus been deemed conclusory and insufficient to establish the defense of unconscionability.''); *see also Deutsche Bank Nat'l Trust Co. v. Pevarski*, *supra*, (holding that a mortgage loan refinancing that was executed after the creditor falsified the defendants' financial information (and which resulted in an increased interest rate and higher monthly payment) was a ''bad deal'' but the terms were ''not so outrageous as to be unconscionable'' and ''courts may not invalidate every bad deal on the grounds of unconscionability.''); Rebecca Schonberg, *Introducing ''Abusive'': A New and Improved Standard for Consumer Protection*, 100 Cal. L. Rev. 1401, 1415-19 (2012).

[23] *See* U.C.C. § 2-302 (2003) (''(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.''). While the UCC is formally limited to transactions involving personal property, courts have noted that it provides ''a useful guide for real property transactions'' as well (see, e.g., Family Fin. Serv., Inc. v. Spencer, 677 A.2d 479, 485 (Conn. App. 1996).

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Subsection (2): Focusing on the Consumer

Subsection 2(A), (B), and (C) are also united by a focus on "the consumer" – not on "consumers" generally. This phrasing suggests that some acts or practices may be abusive as to a single customer (or a very small group) but not others – a suggestion given added weight by Chairman Frank. In a March 29, 2012 House Financial Services Committee hearing, Barney Frank explained:

> People say, "What do you mean by abusive?" We defined it. We defined it in the statute to say it is abusive if it materially interferes with the ability of a consumer to understand the term or a condition; or takes unreasonable advantage of a lack of understanding on the part of the consumer – the risks, costs or conditions; the inability of the consumer to protect the interest.
>
> *In other words, it may depend on the consumer.* And if people think that is some farfetched notion, remember that one of the problems we had with the subprime loans was they were going to an 80-year-old and urging her to refinance when she had nearly paid off her mortgage. *Now, refinancing for some people might be a good idea. When it is sold to an 80-year-old, it is probably not such a good idea.*

[24]

CFPB Director Cordray has endorsed this idea, explaining that "abusive" involves the "facts and circumstances" of individual situations.[25]

By focusing on the relationship of the covered person to the consumer, the "abusive" standard gives the CFPB a tool that is shaped differently from "unfairness." The more established unfairness standard is effective in protecting large classes of consumers, but offers little recourse to consumers whose unique circumstances render them particularly vulnerable – such as the 80 year old described by Chairman Frank. In contrast, the focus on "the consumer" in the "abusive" standard allows the CFPB to provide recourse that is more closely tailored to particular situations. But a legal standard that turns on "the consumer" also makes it very difficult to paint with a broad brush when describing violations of law.

The same tradeoff is indicated by the absence, in the definition of "abusive," of a requirement that the injury be balanced against social benefits from a product or service. In contrast, "unfairness" occurs only where an injury is not "outweighed by countervailing benefits to consumers or to competition."[26] Such a cost-benefit analysis makes sense in the context of an act or practice that is being assessed on a broad basis, lest the "unfairness" standard keep socially useful products and services from the market. The more granular approach required by the "abusive" standard does not require such a backstop, as proof that a product is "abusive" in one context – such as a refinancing offered to an 80-year old – would not preclude the product from being offered to other consumers.

Subsection (2)(A): Lack of Understanding

Under (2)(A), a covered person may not take "unreasonable advantage" of a lack of understanding on the part of the consumer. This language pushes out the frontier of potentially violative conduct. Unlike "deception," the "abusive" standard does not require that the covered person make a misrepresentation or omission. Nor does it require that the consumer's lack of understanding be reasonable. Instead, this language suggests that the covered person may have an affirmative duty to remove, mitigate, or otherwise address the consumer's ignorance, regardless of its origins, before entering into a transaction.

However, proving a lack of understanding requires a tight focus on the consumer, and his or her actual understanding. Here too, Chairman Frank offered a useful, though *post hoc*, explanation. He explained that this standard "says you should not take unreasonable advantage of a lack of understanding. As a case by case – yes – there are mortgage products that are not suitable for an 89-year old woman who has never had her own experience in economic affairs."[27] This reference to the consumer's experience makes clear that, even for an 89-year old woman, the standard requires the same evidence of a lack of understanding.

Instead, this language suggests that the covered person may have an affirmative duty to remove, mitigate, or otherwise address the consumer's ignorance, regardless of its origins, before entering into a transaction.

Consistent with Chairman Frank's view, Director Cordray has explained that a "lack of understanding" sufficient to support an abusive claim is "unavoidably situational,"[28] and that a determination that a violation of 2(A) occurred requires that the Bureau investigate the facts "consumer by consumer."[29] As a practical matter, such a requirement would sharply limit the use of 2(A) to require large scale remediation.

Subsection (2)(B): Inability to Protect

Subsection 2(B) has the same structure as 2(A), but is addressed to a consumer who lacks good options rather than good understanding. This "inability of the consumer to protect" his or her interests need not be the result of any action by the covered person. Poverty, old age, education level, military service, or poor credit all may make a consumer unlikely to receive, or sift through, competing offers for financial products and services. Regardless of the reason why the consumer lacks good options, the covered person may not take "unreasonable advantage" of the consumer's vulnerability.

Section (2)(B) raises difficult questions regarding what it means to take "unreasonable advantage" of a

[24] Transcript, House Committee on Financial Services, "The Semi-Annual Report of the Consumer Financial Protection Bureau," 112th Cong. (March 29, 2012), at 10 (emphasis supplied)
[25] *Id.* at 14.
[26] 12 U.S.C. § 5531(c).
[27] House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit, "The Consumer Financial Protection Bureau: The First 100 Days," 112th Cong. (November 2, 2011).
[28] House Financial Services hearing of March 29, 2012, Transcript at 18.
[29] *Id.*

consumer who fully understands a financial service or product. For example, a customer who cannot obtain credit except from a payday lender may know – from experience or otherwise – the exact fees charged for such a loan. However, he or she may still choose the product because the only alternative (*e.g.*, car repossession, or eviction) is worse. Does the lender take unreasonable advantage of that borrower? Or is the market working? In analyzing this question, what weight (if any) should be given to the consumer's decision to select or use the product? Should the CFPB substitute its judgment as to whether the transaction ultimately served the consumer's interests? Could the same payday loan be abusive or not abusive depending on whether the customer had the option of another source of funds?

The Bureau's answers to these questions will determine whether consumers with poor credit have more or fewer options. Such consumers receive relatively few offers of credit, and those that they do receive often have onerous terms. However, one potential result of aggressive enforcement of subsection (2)(B) could be to discourage lenders of last resort from making loans, with significant consequences for consumers with poor credit or limited means.

The notion that providers of financial products or services must have a reasonable basis to believe that a particular transaction is suitable for the customer has parallels in securities law. When a securities broker-dealer recommends that his or her client buy or sell a particular security, the broker must have a reasonable basis for believing that the recommendation is suitable for that client.[30] This ''know your customer'' rule requires consideration of the client's income and net worth, investment objectives, risk tolerance, and other security holdings.[31]

While Director Cordray has suggested that part of the strength of community banks and credit unions is that they ''know their customers,''[32] the suitability precedent in securities law may be inapposite in the consumer finance sphere. While owning securities ''is not a necessity for living in our economically developed society,'' almost all consumers seek and use credit.[33] In addition, investors tend to be customers of broker-dealers for extended periods of time, which makes it economically feasible for the broker-dealer to invest in becoming familiar with the investor's financial and other capacities. In contrast, some financial products and services are provided in single, arms-length transactions with little prescreening by the creditor.[34] Raising a ''know your customer'' barrier to such credit may inhibit small dollar lending.

Subsection 2(C): Reasonable Reliance

Finally, subsection 2(C) prohibits taking unreasonable advantage of reasonable reliance by the consumer on a covered person to act in the interests of the consumer. Unlike subsection 2(A), this prong of the abusive test requires that the consumer be acting reasonably. However, this standard thereby raises a wide array of questions about when a consumer acts reasonably in relying upon a covered person. Where there is a fiduciary or other relationship of trust and confidence, reliance seems wholly reasonable. However, it is less clear what other circumstances would give rise to reasonable reliance. It is also unclear what would constitute taking unreasonable advantage of such reliance.[35]

As these questions indicate, there is substantial work to be done before a coherent ''abusive'' standard emerges. However, that work can and must be done for ''abusive'' to meaningfully add to the protections provided consumers of financial goods and services. In this article, we suggest an approach to ''abusive'' that is based in the text and legislative history of the ''abusive'' standard, Director Cordray's testimony on the standard, and kindred legal doctrines. Our approach both establishes some boundaries for the application of the new standard and provides a principled basis for its application in specific cases. Most importantly, it seeks to build towards a shared understanding of what does – and does not – constitute an ''abusive'' practice. Our second article will review the Bureau's enforcement cases and analyze whether and how they contribute to the effort to understand the ''abusive'' standard.

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[30] *See, e.g., Fin. Indus. Regulatory Auth., FINRA Manual § 2111*, available at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=15663&element_id=9859&highlight=2111#r15663.

[31] *Id.*

[32] HFS 3/24/11, Tr. at 44.

[33] *See* Written Testimony of Peter Wallison, Arthur F. Burns Fellow, American Enterprise Institute, Creating the Consumer Financial Protection Agency: Hearing on H.R. 3126 Before the S. Comm. On Banking, Housing & Urban Affairs, 111th Cong. (July 14, 2009).

[34] *Id.*

[35] Even fiduciaries may profit from their relationship. For example, Delaware General Corporation Law Section 141(h) provides: ''Unless otherwise restricted by the certificate of incorporation or bylaws, the board of directors shall have the authority to fix the compensation of directors.'' Directors, of course, owe a fiduciary duty to the corporation and to stockholders under Delaware General Corporation Law Section 365. Further, an investment advisor can receive compensation for services performed pursuant to Section 202(a)(11) of the Investment Advisors Act of 1940 (definition of Investment Advisor as ''any person who, for compensation, engages in the business of advising others . . . .''). We note that in May 2012, the SEC amended Rule 205-3 of the Investment Advisors Act of 1940 (17 C.F.R. § 275.205-3) to tighten the rules regarding an investment advisor's ability to charge performance-based compensation.

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