Evaluating Impact of Consumer Harm

Introduction

The following guidance is provided to assist examiners in understanding the impact of consumer harm on examination and supervisory activities. Examination activities promote compliance with federal consumer protection laws, fair lending statutes, the Community Reinvestment Act, and the regulations that implement these laws and statutes. Effective supervision focuses on the areas requiring elevated supervisory attention and promotes the efficient use of resources.

What is Consumer Harm?

"Consumer Harm" is an actual or potential injury or loss to a consumer, whether such injury or loss is economically quantifiable (e.g., overcharge) or non-quantifiable (e.g., discouragement), caused by a financial institution's violation of a federal consumer protection law or regulation, a disregard for supervisory guidance, or a wrongful act by a financial institution or by a third party where the third party was enabled or facilitated by the financial institution. Consumer Harm may be present in a variety of ways and includes:

1. ***Quantifiable harm*** – Economic harm to a consumer where the injury or loss can be measured. For example, a consumer may suffer monetary harm as a result of deceptive marketing practices that entices a consumer to purchase a product without having accurate information regarding the benefits, costs, or terms of the product in violation of Section 5 of the Federal Trade Commission Act. Similarly, if a Bank employs a pricing structure that allows significant discretion, without effective monitoring or controls, resulting in Hispanic borrowers being charged higher prices on average than similarly situated non-Hispanic borrowers in violation of the Equal Credit Opportunity Act, then the higher prices paid by the Hispanic borrowers over similarly situated non-Hispanic borrowers is quantifiable consumer harm.

2. ***Non-quantifiable harm*** – Injury or loss to the consumer that cannot be measured, or is very difficult to measure, yet the consumer still suffers some form of economic or other harm. For example, a consumer could be injured economically when a financial institution unfairly denies the consumer credit or discourages an application on a prohibited basis in violation of the Equal Credit Opportunity Act, but calculating a monetary value for the injury may be challenging. Another example may be a bank that imposes additional requirements on consumers to submit billing disputes that are not permitted by law or are not accurately disclosed in the bank's error resolution disclosures. The practices could discourage a consumer from filing a dispute. Consumer harm exists, but may be difficult to identify and/or quantify.

3. ***Potential harm*** – Involves financial institution activities (or failure to take action) that create the possibility that a consumer may be harmed. An example of potential consumer harm is a violation of the regulations that implement the National Flood Insurance Act of 1968 where the financial institution failed to require flood insurance on a residence at loan closing. The consumer has not suffered actual loss but is exposed to potential economic loss should a flood occur.

Consumer harm is a broad concept and the examples provided here are not all inclusive. Consumer harm is not limited to monetary loss, can be quantifiable or non-quantifiable, can be actual harm or potential harm, and may be caused by activities conducted through third-party relationships.

How does Consumer Harm Impact Examination Activities?

The concept of consumer harm is an important consideration in all examination and enforcement efforts, including examination strategies, examination scoping activities, assessment of the compliance management system (CMS), presentation in examination reports, supervisory actions, and communication with bankers. The FDIC's mission of promoting public confidence in the financial system is best served through a supervisory approach focused on identifying, addressing, and preventing consumer harm.

- *Identification* – Supervisory and examination activities are driven by a focus on identifying the risk of consumer harm that may occur in a financial institution's business activity.

- *Addressing identified risks* – When risks of consumer harm are identified, examiners should ensure the institution takes appropriate action to address or mitigate these risks. Corrective action for violations of law and regulations should remediate consumer harm when it occurs and remove underlying incentives to engage in practices harmful to consumers. Where there is a violation of law and/or regulation, the extent and severity of consumer harm informs the type and scope of enforcement action sought to correct the violation.

- *Prevention* – Supervisory efforts should encourage institutions to have effective compliance systems to avoid and mitigate risks of consumer harm. To support that effort, examination and other staff communicate information and best practices in a variety of settings to assist institutions in managing risks of consumer harm in the conduct of their business.

Identifying, addressing, and preventing consumer harm is an important consideration in all examination and enforcement activities, as discussed below.

Supervisory Strategies

The FDIC's supervisory strategies are designed to promote compliance with consumer protection laws and regulations in FDIC-supervised institutions. Some of the activities used to implement our supervisory strategies include examinations, targeted reviews, visitations, investigations, and offsite analysis of how the bank manages its consumer compliance responsibilities. The timing or frequency of these activities can be adjusted based upon indications of risk of consumer harm, such as consumer complaints, referral from other divisions or agencies, changes in the institutions products or services, or reliance on third parties to offer products and services to bank consumers. Supervisory strategies should be flexible to respond to indications of increasing or decreasing risk of consumer harm.

Examination Scoping Activities

Examiners have several tools available to them to assist them in identifying risks of consumer harm. The Risk Profile and Scoping Memorandum (RPSM) has been designed to assist examiners in evaluating risks of consumer harm through an analysis of an institution's historical CMS, the products and services currently offered, and existing and new third party relationships. Examiner judgment is the most critical aspect of properly evaluating an institution's risk profile and the RPSM guides the examiner in tailoring the examination to focus primarily on those areas that present the highest risk of consumer harm, since examiners are unable to review all aspects of an institution's compliance at any given examination. These pre-examination planning processes, including the automated pre-exam questionnaire and document request (C-PREP) assist examiners in requesting the appropriate information during the scoping process to identify areas of the greatest risk of potential consumer harm.

Examination Procedures

Examination procedures are drafted and implemented in a manner to guide examiners in assessing the risk of consumer harm in the conduct of the examination. Well-crafted examination procedures focused on risks and potential for consumer harm promote the efficient use of resources, identification of root causes of problems, and allocation of resources to areas and institutions presenting the highest risk, while avoiding unnecessary review of areas with little or no risk of consumer harm. As an example, examination procedures regarding overdraft payment programs differentiates the type and extent of review based on the type of overdraft program offered (e.g., automated versus ad hoc) and further reserves more detailed transaction testing to situations where examiners have identified specific risks or weaknesses.

Report Presentation

The Report of Examination plays an important role in communicating the FDIC's assessment of the compliance program to the institution. In the event violations of federal consumer laws are identified, the Report uses a classification system based on the level of risk of consumer harm. This classification system serves to communicate the FDIC's focus on the severity, extent, or potential for consumer harm caused by the violation. The expectation is that FDIC supervised institutions will prioritize corrective action and on-going management of their CMS to mitigate risks of consumer harm.

Supervisory Actions

Effective supervision includes requiring institutions to take corrective action when weaknesses in the CMS or violations are identified. Appropriate corrective action considers the overall effectiveness of the institution's CMS, the root cause(s) of the deficiencies as well as the extent and impact of consumer harm. When there is a violation of law or regulation that results in consumer harm, the FDIC will seek corrective action, which may include restitution to consumers as part of an appropriate enforcement action. Civil money penalties may also be assessed to sanction an institution or an institution-affiliated party according to the degree of culpability, intent, and severity of the violation of law or regulation, breach of fiduciary duty, and/or unsafe or unsound practice, and also to deter future misconduct.

Communication and Technical Assistance

Communication and technical assistance to supervised institutions is an important component of the FDIC's supervisory approach in preventing consumer harm by supporting institutions' efforts to maintain an effective CMS. Communication is especially important during periods of regulatory change and transition. The FDIC communicates through a number of channels, including national and regional bankers' teleconferences on emerging topics; speaking engagements at national, regional, state, and local conferences and conventions; a web-based regulatory calendar; Supervisory Insights Journal articles; regional newsletters; banker and bank director trainings and online videos; meetings with industry trade groups; and issuance of guidance through Financial Institution Letters. Communicating the focus of our examination efforts and our supervisory priorities through these diverse channels assists bankers in reviewing key areas of concern and addressing deficiencies promptly, prior to and unrelated to a specific examination activity. In addition, examiners can provide certain types of technical assistance to community bankers during the course of an examination that may enable an institution to reduce the risk of consumer harm in the operation of its business. These communication and technical assistance efforts serve to prevent consumer harm by giving bankers tools to address issues that may pose risk of consumer harm.

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