



# **Keeping on the Right Side of Fair Lending**

**July 20, 2022**



# Agenda

- Heightened Concerns of the CFPB
- Revival of the “Dormant” Authority Over Institutions that “Pose Risk” and the Implications for Fair Lending
- The Use of UDAAP to Address Discrimination
- “Black Box” Models and Adverse Action
- Other Developments – Speed Round
- Recommended Best Practices

# Heightened Concerns of the CFPB

- Communities of color, military-connected families, older Americans, first-time homeowners
- Algorithmic bias
- “Unfair” discrimination in consumer finance
- Repeat offenders and large players engaged in large scale harms

# Revival of the Dormant Authority Over Institutions that Pose Risk

- CFPB announces “Revival” on April 25, 2022
- Gives the CFPB supervisory jurisdiction to examine non-bank companies per Section 1024(a)(1)(C) of Dodd Frank
- Administrative procedure per 12 C.F.R. pt. 1091
  - Initiated by Notice of Reasonable Cause based either on complaints or “other information”
  - Recipient has 30 days to submit a written response and can request an opportunity to present an oral response
  - Recommended determination made by Associate Director
  - Final determination made by CFPB Director

# Revival of the Dormant Authority Over Institutions that Pose Risk

- CFPB is gathering “Other Information” through Market Monitoring Letters issued under Section 1022(c)(4)(B)(ii) of Dodd Frank
  - So far Market Monitoring Letters have been sent to technology companies (10/21/21) and BNPL Lenders (12/16/21)
- Market Monitoring Letters signal the use of the “pose risk” authority for fair access and fair lending purposes
  - Tech company letters ask about product delivery, targeted marketing, disclosures and demographics
  - BNPL Letters similarly ask about underwriting, disclosures, credit score complaints and demographics

# The Use of UDAAP to Address Discrimination

- March 16, 2022 – CFPB issued press release to announce changes to its supervisory operations
- CFPB takes the position that discrimination, both intentional and unintentional, and in connection with any financial products, constitutes an Unfair, Deceptive or Abusive Act or Practice
- Also updated exam manual for evaluating UDAAPs to say that intention and unintentional discrimination may meet the criteria for unfairness

# The Use of UDAAAP to Address Discrimination

- Press release accompanied by blog post – “Cracking down on discrimination in the financial sector”
- "The updated manual guides examiners in looking beyond discrimination directly connected to fair lending laws, asking them to review any policies or practices that exclude individuals from products and services, or offer products or services with different terms, in an unfairly discriminatory manner."
- Director Chopra: “[w]e will be expanding our anti-discrimination efforts to combat discriminatory practices across the board in consumer finance."

# The Use of UDAAP to Address Discrimination

- What does this mean? CFPB will be looking beyond the scope of ECOA for discrimination.
- Where ECOA and FHA relates to extensions of credit, CFPB may seek to leverage UDAAP authority for any aspect of any financial product or service
- Ex. Discrimination in the opening of an account.
- The CFPB confirmed that it will examine for discrimination in all consumer finance markets, including credit, servicing, collections, consumer reporting, payments, remittances, and deposits



# The Use of UDAAP to Address Discrimination

- CFPB examiners will require supervised companies to show their processes for assessing risks and discriminatory outcomes, including documentation of customer demographics and the impact of products and fees on different demographic groups.
- The CFPB will look at how companies test and monitor their decision-making processes for unfair discrimination, as well as discrimination under the ECOA.
- The examination manual includes objectives is to assess the quality of the regulated entity's compliance risk management systems for avoiding UDAAPs – including whether the entity has a process to prevent discrimination in all aspects of consumer financial products or services the entity offers or provides.
- The manual also addresses whether the entity has appropriate training for consumer service personnel to prevent discrimination.

# The Use of UDAAP to Address Discrimination

- Announcement raises new questions and challenges
- Is UDAAP approach limited to existing prohibited bases under fair lending?
  - Could we see approach used if creditor does not extend credit to persons covered under the Military Lending Act? Or different risk pricing for renters v. homeowners?
- Regulation by press release/blog post - No public input or Congressional oversight (unlike rulemaking)

# “Black Box” Models and Adverse Action

- Innovation Spotlight – Blog Post by Ficklin, Pahl, and Watkins (7/7/20)
  - Posited that the existing flexibility for adverse action notices could be compatible with AI
  - Supported the use of new technology to expand access to credit
- Tech Sprint on Electronic Disclosures for AA Notices (10/5/20 – 10/19/20)
  - Topics included refining methods for translating model factors into adverse action reasons
  - Some projects did attempt to improve algorithmic credit decision notices
- CFPB Request for Information on the ECOA and Regulation B (8/3/20)

# “Black Box” Models and Adverse Action

- CFPB Circular 2022-03 (5/26/22) – The Question
  - When creditors make credit decisions based on complex algorithms that prevent creditors from accurately identifying the specific reasons for adverse actions so these creditors need to comply with the ECOA’s requirement to provide a statement of specific reasons to the applicant against whom adverse action is taken?

# “Black Box” Models and Adverse Action

- CFPB Circular 2022-03 (5/26/22) – The Response
  - Yes, creditors need to comply with adverse action notice requirements (need an “interpretable” model or must be able to bvalidate the accuracy of post-hoc “explanations” that “approximate models”
  - Complicated technology is not a defense to compliance
  - Technology that is too complicated violates the ECOA and Regulation B

# Other Developments

## Limited English Proficiency

- CFPB Releases Statement Regarding the Provision of Financial Products and Services to Consumers with Limited English Proficiency on January 13, 2021
- CFPB Releases Spanish Translations of Various Disclosures on May 11, 2022 - Includes Adverse Action and Credit Reporting Notices

## Sexual Orientation and Gender Identity

- CFPB interprets prohibition against discrimination on the basis of sex to include discrimination based on sexual orientation and/or gender identity
- Interpretive Rule 2021-03 effective March 16, 2021, published at 86 Fed. Reg. 14363-66 (Mar. 16, 2021)

# Other Developments

## Special Purpose Credit Programs

- CFPB and other Agencies Issue Statement on Special Purpose Credit Programs under the ECOA and Regulation B on February 22, 2022

## Advisory Opinion on Coverage of Fair Lending Laws

- CFPB issues Advisory Opinion on May 9, 2022, stating that ECOA and Regulation B prohibit lenders from discriminating against customers during the life of the loan and not just during the application

# Other Developments

## Supervisory Highlights

- 2021 Fall Supervisory Highlights
  - Lenders were cited for discriminating when granting pricing exceptions
  - Small business lenders were cited for asking about and using an applicant's religion in evaluating creditworthiness
- 2021 Summer Supervisory Highlights
  - Lender was cited for violating ECOA and Regulation B because of direct mail campaigns with only non-Hispanic white models



# Other Developments

## Enforcement Actions

- Suit against LendUp filed in September of 2021, alleges failure to provide timely and accurate adverse action notices (problems with principal reasons)
- Suit settles in December of 2021 with requirement for LendUp to comply with ECOA

## Significant Cases

- CFPB joins in Amicus Brief in *Fralish v. Bank of America, N. A.*, (7th Cir.) arguing that ECOA and Regulation B prohibit discrimination after credit is granted
- Alleged substantive violation was failure to provide adverse action notice and reasons for credit card account termination

# **Recommended Best Practices**

## **Panel Discussion**

# Questions/Discussion

If you would like to ask a question, you can ASK or type your question into the CHAT feature NOW.