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What You Should Know About Fair Lending Compliance in 2024

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Agenda

- Types of Fair Lending Discrimination
- Equal Credit Opportunity Act
- Fair Housing Act
- UDAP/UDAAP
- Other Anti-Discrimination Laws
- Fair Lending Hot Topics

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Generally Recognized Types of Discrimination

Overt

- "You know it when you see it"
- Overt does not necessarily mean deliberate and can be unintentional.

Disparate Treatment

- Differences or inconsistencies in treatment based on prohibited factors that are not fully explained by relevant, non-discriminatory factors.
- Most common type of discrimination.

Disparate Impact

- Facially neutral policy has an adverse impact on a protected class
- Least common type of discrimination for fair lending reviews but may increase
  - Algorithmic bias
  - A.I.

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Primary Fair Lending Laws

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Equal Credit Opportunity Act (ECOA)

- 15 USC § 1691, *et seq.* and Regulation B, 12 C.F.R. part 1002, *et seq.*
- **Discrimination:** "It shall be unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction" on a prohibited basis.
- **Discouragement:** "A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application."
- **Prohibited Bases:** Race, color, religion, national origin, sex (including sexual orientation and gender identity), marital status, age, income from public assistance, exercise of rights under the Consumer Credit Protection Act. (There are special rules allowing the use of age in credit evaluation under certain circumstances.)

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ECOA Technical Requirements

- **ECOA and Regulation B also:**
  - Set standards for timeliness and notification of application decisions
    - Applicants for credit must be notified of the action being taken on their applications within 30 calendar days.
    - A written notice of adverse action (denial or counteroffer) must include: creditor name and address; a statement of the action taken; a statement of the specific reasons for the action (or of the applicant's right to request the reasons); and the standard ECOA notice found in Regulation B (including the name and address of the federal agency that administers compliance with the ECOA).
    - A written notice of incompleteness must include statements requesting the information needed from the applicant; specifying a reasonable period of time or the date by which creditor must receive the missing information; and noting that failure to provide the requested information will result in no further consideration being given to the application.
  - Ensure access to appraisals and estimates of value

- **ECOA Enforcement**
  - Enforced by CFPB, DOJ, NCUA, OCC, FRB, FDIC, FTC, state agencies
  - Referral to DOJ for “pattern and practice” of discrimination

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ECOA Civil Liability

- $10,000 in individual actions and up to the lesser or $500,000 or 1% of the creditor’s net worth in class actions.
- In an action by a federal agency, additional remedies may be available, including remediation for affected consumers.
- The Dodd-Frank Act also provides the CFPB with extensive authority to remedy violations of federal consumer financial laws, including ECOA. These expansive remedies include:
    - Rescission or reformation of contracts
    - Actual and punitive damages
    - Costs and attorney’s fees
    - Public notification of the violation
    - Limits on the activities or functions of the violator
    - Civil money penalties (>$5,000 per day; >$25,000 per day for reckless violations; >$1,000,000 per day for knowing violations)

The statute of limitations for ECOA violations is five years.

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Fair Housing Act (FHA)

- 42 U.S.C. §§ 3604-3605
- **Prohibited Bases:** The Fair Housing Act prohibits discrimination in connection with mortgage and other housing-related transaction because of a person's race, color, religion, sex (including sexual orientation and gender identity), familial status, disability or national origin.
- **Prohibited Conduct:** With respect to a member of a protected class, FHA makes it unlawful to:
  - "Refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling."
  - "Discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith."
  - "Represent to any person … that any dwelling is not available for inspection, sale, or rental when such dwelling is in fact so available."
  - "Discriminate against any person in making available [a 'residential real estate-related'] transaction, or in the terms or conditions of such a transaction."
    - "The term 'residential real estate-related' transaction includes making and purchasing loans secured by residential real estate, insuring such loans or such real estate, and selling, brokering, or appraising such real estate."

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FHA Enforcement

- DOJ, HUD have authority to make Fair Housing Act claims, not the CFPB
- HUD Investigations
  - HUD on its own initiative or upon receipt of a complaint from an “aggrieved person” may initiate an investigation of allegedly discriminatory housing practices.
  - HUD seeks conciliation between the parties and such agreements are public absent agreement.
- Attorney General Actions
  - Pattern and Practice. AG may file suit where it has reasonable cause to believe that any person is engaged in a “pattern or practice” of discrimination.
  - Referral from HUD.
  - Intervention in private lawsuit. AG may intervene in private suits of general public importance.
- Private Actions
  - Private plaintiffs may commence a civil action within 2 years after the later of the occurrence of an alleged discriminatory housing practice.
  - 2-year period is tolled during the pendency of any related administrative proceeding.

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FHA Civil Liability

- Effective March 16, 2021, the U.S. Department of Housing and Urban Development (HUD) published new inflation-adjusted civil penalty amounts for individuals or entities that have been found to have violated a variety of different housing-related laws, including the federal Fair Housing Act (FHA).
  - Maximum civil penalty of $21,663.00 for the first violation of the Fair Housing Act.
  - Respondents who have violated the Fair Housing Act in the previous 5 years can be fined a maximum of $54,157.00.
  - Respondents who have violated the Act two or more times in the previous 7 years can be fined a maximum of $108,315.00.
- Punitive damages may be awarded by federal district courts.
- Non-economic damages may also be awarded for the humiliation, mental anguish, and/or psychological injuries of the plaintiff.
- Plaintiff’s attorney fees and costs

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UDAP/UDAAP

Unfair

Causes or is likely to cause substantial injury to consumers;

Injury is not reasonably avoidable by consumers; and

Injury is not outweighed by countervailing benefits to consumers or to competition

Deceptive

Representation, omission, act, or practice that misleads or is likely to mislead the consumer;

Consumer's interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and

The misleading representation, omission, act, or practice is material

Abusive

Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or

Takes unreasonable advantage of:

- Consumer's lack of understanding of the material risks, costs, or conditions of the product or service;
- Consumer's inability to protect its interests in selecting or using a consumer financial product or service; or
- Reasonable reliance by the consumer on a covered person to act in the interests of the consumer

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UDAP/UDAAP: The Gap Filler

Non-Credit Areas

- Deposit Accounts
- Savings Accounts
- Payments
- Purchase / Sale Financing Arrangements (Factoring, MCA, etc.)
- Some BNPL Products
- Etc.

Categories that are not Protected under ECOA

- Limited English Proficiency (LEP)
- Geographic Area
- Disability
- Veteran Status
- Familial Status (Beyond Marital Status)
- Etc.

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UDAP/UDAAP: The Gap Filler

Coverage under ECOA

- Application: Credit Products
- Types of Prohibited Discrimination:
  - Overt
  - Disparate Treatment
  - Disparate Impact
- Basis for Discrimination: Limited by ECOA's list of protected categories.

Coverage under UDAAP

- Application: Credit and non-Credit Products
- Types of Prohibited Discrimination:
  - Overt
  - Disparate Treatment
  - Disparate Impact
- Basis for Discrimination: Apparently unlimited.*

Other Anti-Discrimination Laws

- State anti-discrimination laws – most states have analogous anti-discrimination laws, some of which have broader substantive coverage or additional prohibited than federal fair lending laws.
  - Examples: California Unruh Act, New York Executive Law 296-a
- Section 1981 – Section 1981 of the Civil Rights Act, 42 U.S.C. § 1981, provides in pertinent part that all persons "shall have the same right . . . to make and enforce contracts." 42 U.S.C. § 1981(a).

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Fair Lending Hot Topics

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Algorithmic Bias and Artificial Intelligence

- Director Chopra's concerned about algorithmic decisioning in 2019
  - Arguing that algorithms are not, in fact, neutral – noting that "valid inputs can produce discriminatory results."
- Consumer Financial Protection Circular 2022-03
  - Creditors can violate ECOA and Reg. B when the make credit decisions based on algorithms that prevent creditors from accurately identifying the specific reasons for denying credit or taking other adverse actions.
- CFPB Approves Rule on Algorithmic Bias and Home Appraisals (June 24, 2024)
- CFPB calls tech workers to be whistleblowers and report discrimination from AI and technology

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Algorithms, A.I., and Fair Lending: Special Challenges

- Does your input data violate ECOA?
- Can your input data be used as a proxy for a protected class?
- How does your algorithm operate?
- How can you determine whether good inputs result in discriminatory output?
- Are you systematically auditing your underwriting decisions?
- What about third party vendors?
- What about UDAAP?

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Working with Third Parties

- Third Party Vendors and the Regulatory Landscape
  - CFPB Has Authority to Enforce Consumer Protection Law with regard to Vendors
  - CFPB is Flexing its “Dormant Authority” to examine non-bank Financial Institutions
- “Given the rapid growth of consumer offerings by nonbanks, the CFPB is now utilizing a dormant authority to hold nonbanks to the same standards that banks are held to,” said CFPB Director Rohit Chopra. “This authority gives us critical agility to move as quickly as the market, allowing us to conduct examinations of financial companies posing risks to consumers and stop harm before it spreads.”
- CFPB can examine if it has “reasonable cause to determine [that the activity poses] risk to consumers.”

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Working with Third Parties

- Third Party Vendors and the Regulatory Landscape
    - CFPB Bulletin 2016-02

        "[T]he mere fact that a supervised bank or nonbank enters into a business relationship with a service provider does not absolve the supervised bank or nonbank of responsibility for complying with consumer Federal consumer financial service law to avoid consumer harm."

- CFPB Expects that lenders will have an effective risk management process.
- The revised UDAAP Exam Manual expects covered entities to "monitor[] the activities of employees and third-party contractors, marketing sales personnel, vendors, and service providers to ensure they do not engage in unfair, deceptive, or abusive acts or practices with respect to consumer interactions."

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Underwriting and Pricing Considerations

- Underwriting and "exclusionary practices"
  - Immigration status – CFPB/DOJ Joint Statement on Immigration Status (October 2023)
    - *For example, if a creditor has a blanket policy of refusing to consider applications from certain groups of noncitizens regardless of the credit qualifications of individual borrowers within that group, that policy may risk violating ECOA and Regulation B. This risk could arise because some individuals within those groups may have sufficient credit scores or other individual circumstances that may resolve concerns about the creditor's rights and remedies regarding repayment.*
  - Geography – e.g., US territories and tribal lands
  - Income type – e.g., Section 8 Housing Vouchers, maternity leave income, SSDI
- Pricing
  - Pricing exceptions – frequency of pricing exceptions across different borrower groups

Pricing Exceptions

- CFPB Supervisory Highlights Report (2021 and 2023)
- Cited violations of the Equal Credit Opportunity Act (ECOA) by mortgage lenders.
  - Alleged discrimination against minority and female borrowers in the granting of pricing exceptions, compared to non-Hispanic white and males.
- Lenders allegedly lacked oversight and control over how sales staff granted pricing exceptions to customers.
  - Examiners identified lenders with statistically significant disparities for incidences of pricing exceptions.
  - Weaknesses in policies and procedures, including limited documentation requirements
  - Failure of loan officers to follow policies and procedures
  - Lack of oversight and control over loan officers’ discretion in connection this exception
  - Managements’ failure to take appropriate corrective action in response to observed disparities

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What is Redlining?

- Redlining refers to the practice of **denying financial services** to residents of certain geographic areas based on the racial or ethnic makeups of those areas. Historically, the federal government and certain institutions literally drew red lines on maps to indicate neighborhoods in which institutions should not insure properties or make loans.
- Now, regulators use the concept of “redlining” much more broadly:
  - Redlining is “a form of illegal disparate treatment in which a lender provides **unequal access to credit**, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located.”
  - *FFIEC Interagency Fair Lending Examination Procedures Manual (Aug. 2009)*

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Common Redlining Consent Order Provisions

- Civil money penalties
- Loan subsidy funds
- Opening branches or LPOs
- Community partnerships
- Advertising and community outreach
- Hiring/assignment of LOs

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Digital Redlining

- Traditional redlining considerations are merging with evolving concerns around algorithmic bias.
- For example, in 2022, the DOJ settled with Meta to resolve allegations of discrimination in marketing under the Fair Housing Act.
  - Allegations that Meta discriminated based on protected characteristics by restricting who can view housing-related ads on the platform
  - Meta allegedly “enabled advertisers to exclude people whom the company classified as parents; non-American-born; non-Christian; interested in accessibility; interested in Hispanic culture; or a wide variety of other interests that closely align with the Fair Housing Act’s protected classes”

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Regulators Use of Reporting Data to Combat Redlining

- Focus on peer comparison as a baseline for redlining review.
  - Were lender's applications/originations in majority-minority census tracts statistically different from peer lenders?
- Use HMDA data instead of CRA assessment area.
- Mere statistically significant difference not enough for violation. Must also prove intent.
  - Explicit intent shown through acts such as discouragement
  - Implied intent shown through review of marketing efforts, affirmative efforts to target majority-minority census tracts
- Treatment of all census tracts the same seemingly no longer enough. Recent trend looks at steps taken to promote access, including branch locations, marketing efforts, ethnicity of loan officers, etc.

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Reporting Requirements

- Home Mortgage Disclosure Act
  - Ensuring financial institutions to report data on mortgage loan applications, purchases, and originations.
- Community Reinvestment Act
  - Ensuring covered FDIC- insured depository institutions to meet credit needs of low and moderate income neighborhoods and includes reporting requirements.
  - Fed. Chairman Jerome Powell and members of Congress support the expansion the Act to non-depository institutions offering consumer credit, including fintech companies.
- Section 1071 of the Dodd-Frank Act
  - Requiring creditors to determine whether a business is a women-owned, minority-owned, or small business and to collect other data points from business regarding the principal owners of the business and provide data to the CFPB.

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Questions?

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