

# Banking & Finance

## Consumer Financial Protection Bureau

### Fair Lending

#### Preparing for the New Challenges of Fair Lending



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Fair lending is not a new concept for lenders. Thanks to the Consumer Financial Protection Bureau (CFPB), however, fair lending now presents greater challenges for providers of consumer credit products and services. The new challenges stem from CFPB's focus on and approach to fair lending, and the resources that CFPB may devote to fair lending enforcement. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) not only created CFPB,<sup>1</sup> but also directed CFPB to create an Office of Fair Lending & Equal Opportunity.<sup>2</sup> Consumer credit product and service providers must prepare for broader and more rigorous assessments under fair lending laws.

This article addresses the approach of CFPB and how providers of consumer credit products and services can prepare themselves to withstand broadened and heightened fair lending scrutiny.

#### Fair Lending Beyond Origination

Traditionally, fair lending assessments focused on whether protected class members were denied credit or received less favorable credit terms based on discrimination or based on non-discriminatory factors, such as credit score and income.<sup>3</sup>

On CFPB's watch, however, the *servicing* of credit products will also be assessed for fair lending issues, particularly the servicing of loans that are in default.<sup>4</sup> The industry should expect that CFPB will assess whether a servicer's consideration of a borrower for a forbearance, modification, or similar relief measure varies based on whether the borrower is a protected class member. Servicers also should expect that CFPB will assess whether protected class borrowers experience a higher rate of foreclosure, collection litigation, repossession, or similar actions and, if so, whether any discriminatory factors are involved. CFPB has advised that it is engaging in "early-stage research" to identify new fair lending investigations that it will pursue.

Industry members should review both their origination and servicing policies, procedures, and practices for fair lending concerns. A particularly careful eye should be devoted to areas in which employees have discretion in making decisions with regard to consumers' accounts. Initial training of new employees, and continuing training of existing employees, regarding fair lending laws, and company policies and procedures to comply with the laws, is an important aspect of fair lending compliance. Finally, monitoring of actual practices and results with regard to both origination and servicing will be essential. In addition to the traditional assessments of denial rates and credit terms for origination operations, assessments also should cover the extent

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to which forbearance, modification, and other relief measures were offered and implemented, and the experiences of various classes of consumers with regard to collection activities.

### “Equitable Access to Credit”

In addition to the focus on discrimination in the origination and servicing of credit transactions, CFPB also considers “equitable access to credit” to be a fundamental part of its mission.<sup>5</sup> The Dodd-Frank Act in fact provides that the functions of CFPB’s Office of Fair Lending and Equal Opportunity include examining “the fair, equitable, and nondiscriminatory access to credit for both individuals and communities” under the laws enforced by CFPB, including the Equal Credit Opportunity Act.<sup>6</sup>

CFPB has indicated that it will conduct research and analysis on equitable access to credit.<sup>7</sup> Although traditional fair lending assessments mainly focused on how consumers were treated once they commenced the application process, examinations of how lenders deal with consumers in the pre-application stages and market their credit services is not new. Recent Department of Justice (DOJ) investigations have assessed a lender’s lack of solicitation efforts in protected class communities, the low rate of credit applications received from such communities (as compared to the rate of applications received by the lender from non-protected class communities), and the applications received from protected class communities by peers of the lender. DOJ believed that the factors reflected an intent to deny or discourage access to credit on a discriminatory basis.<sup>8</sup>

The equitable access to credit analysis presents challenges for lenders. There is uncertainty regarding what standards CFPB will use to determine whether a lender is providing equitable access to credit. Potential factors could include the quality and quantity of marketing and outreach efforts to protected class members, whether the number of credit applications from protected class members appears to be appropriate based on the communities served, the rate of applications from protected class members received by peers of the lender, and the methods by which the products or services of the lender can be obtained. For example, for a traditional brick and mortar lender, CFPB likely would assess the extent to which offices are placed in or near protected class communities.

In recent years, regulators have assessed whether higher-cost credit products were specifically targeted to protected class members. CFPB intends to assess consumer credit products offered by lenders in general, and fair lending issues will be part of the assessment. The scope potentially can be much broader than simply whether less favorable products were targeted to protected class members, and may extend to whether the product mix offered by the lender is appropriate to promote equitable access to credit. The lack of any defined yardstick that may be used for such an assessment is an issue, and there is a concern that CFPB may provide fair lending guidance through individual enforcement actions and not through rulemaking or similar regulatory guidance. Without upfront guidance from CFPB, lenders will not be able to appropriately assess whether

their product mix, pricing terms, and marketing practices sufficiently provide for equitable access to credit, however that may be measured. Moreover, a lender considering an increase in its outreach to protected class consumers may hesitate based on the concern that its efforts may later be interpreted under principles developed by CFPB as targeting less favorable credit products or terms to such consumers.

Despite the lack of current guidance from CFPB, lenders should assess whether there can be adjustments made to their products and pricing that may enhance credit opportunities for protected class members. Lenders also should assess if their marketing reaches protected class members and communities, whether they should implement specific outreach efforts to encourage applications from protected class members, and whether any existing outreach efforts can be improved.

### Implications of Market and Data Analysis

The Dodd-Frank Act directs CFPB to establish a unit to research, analyze, and report on various matters, including access to fair and affordable credit for traditionally underserved communities, and also developments in markets for consumer financial products or services, including market areas of alternative consumer financial products or services with high growth rates and areas of risk to consumers.<sup>9</sup> CFPB has a robust Research, Markets, and Regulations Division, and will use market and data analyses conducted by the Division to support its fair lending efforts.

As a practical matter, this means that CFPB will support assertions of fair lending law violations with market and/or data analyses, and industry members will need to have their own market and/or data analyses to contest the allegations. The use of data analysis by the government is not new. For example, traditionally the government has supported allegations of fair lending violations involving residential mortgage loans based on an analysis of loan-level data reported by individual lenders under the Home Mortgage Disclosure Act (HMDA). Lenders could defend the assertions by providing their own data analysis. A lender would be in a position to conduct a more thorough data analysis, because it could include in the analysis both HMDA data and credit-related data that are not included in the HMDA data. Going forward, however, CFPB data analyses likely will be more difficult to challenge because the HMDA data will be greatly expanded to include much more credit-related information,<sup>10</sup> and CFPB simply will be able to devote greater resources to such analyses.

The use of market analyses by CFPB also may prove to be challenging for the industry. For example, CFPB may assert that based on a market analysis it believes a lender needs to offer certain types of credit products or terms in order to provide equitable access to credit. Based on the potential for such an assertion, a lender may decide to engage in its own market analysis to assess its existing product mix and evaluate changes to or the addition of products. But without upfront guidance from CFPB, the lender would not know if its assessment addressed issues of concern to CFPB.

There is a clear course of action, however, with regard to data analyses. Once CFPB makes the assertion that, based on a data analysis, it believes a lender may have violated the fair lending laws, it will be too late for the lender to start its own analysis. More than ever, lenders will need to regularly monitor their lending activity through their own analysis of data. Lenders also should use market analyses in evaluating their credit products and prices, and keep tuned to CFPB actions to better inform the approach used for such analyses.

A potential speed bump for CFPB in pursuing an aggressive fair lending agenda was the case of *Magner v. Gallagher*, in which the U.S. Supreme Court was poised to consider whether claims of discrimination based on disparate impact may be brought under the Fair Housing Act.<sup>11</sup> Now that the case has been dismissed, CFPB will presumably continue to focus on both disparate treatment and disparate impact analyses, both of which rely heavily on statistical data. For lenders, getting ahead of CFPB's statistical analysis will be critical, because the cost of litigating a fair lending issue likely exceeds the cost of instituting the sort of data analysis that could discourage a CFPB enforcement action in the first instance.

## Conclusion

CFPB's focus on and approach to fair lending enforcement will further raise the compliance burden on providers of consumer credit products and services. Industry members will need to include all aspects of their consumer credit products and services in their fair lending assessments, regularly conduct data analyses of their lending results, conduct market studies with regard to their products and prices, and keep abreast of CFPB actions to better understand what CFPB will expect from the industry.

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<sup>1</sup> Pub. L. 111-203 § 1011 (2010).

<sup>2</sup> Pub. L. 111-203 § 1013(c) (2010).

<sup>3</sup> See, e.g., *Ramirez v. GreenPoint Mortg. Funding, Inc.*, 633 F. Supp. 2d 922 (N.D. Cal. 2008); *Paschal v. Flagstar Bank*, 295 F.3d 565 (6th Cir. 2002); *United States v. First Nat'l Bank of Dona Ana County*, No. 97-cv-00096 (D.N.M. 1997); U.S. Department of Justice, *Justice Department Reaches \$335 Million Settlement to Resolve Allegations of Lending Discrimination by Countrywide Financial Corporation* (Dec. 21, 2011), available at <http://www.justice.gov/opa/pr/2011/December/11-ag-1694.html>.

<sup>4</sup> See Consumer Financial Protection Bureau, *Supervision and Examination Manual, Mortgage Servicing – Examination Procedures*, Module 8: Loss Mitigation (2011).

<sup>5</sup> See Consumer Financial Protection Bureau, *Addressing Credit Discrimination* (Dec. 14, 2011), available at <http://www.consumerfinance.gov/addressing-credit-discrimination/>.

<sup>6</sup> Pub. L. 111-203 § 1013(c)(2) (2010).

<sup>7</sup> See Consumer Financial Protection Bureau, *Addressing Credit Discrimination* (Dec. 14, 2011), available at <http://www.consumerfinance.gov/addressing-credit-discrimination/>.

<sup>8</sup> See U.S. Department of Justice, *Justice Department Reaches Settlement with Citizens Republic Bancorp Inc. and Citizens Bank Regarding Alleged Lending Discrimination in Detroit* (May 5, 2011) available at <http://www.justice.gov/opa/pr/2011/May/11-cr-576.html>; U.S. Department of Justice, *Justice Department Reaches Settlement with Midwest BankCentre Regarding Alleged Lending Discrimination in St. Louis* (June 16, 2011) available at <http://www.justice.gov/opa/pr/2011/June/11-cr-784.html>.

<sup>9</sup> Pub. L. 111-203 § 1013(b)(1) (2010).

<sup>10</sup> Pub. L. 111-203 § 1094 (2010).

<sup>11</sup> *Magner v. Gallagher*, No. 10-01032 (cert. granted Nov. 7, 2011).