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Trends From CFPB's Unwavering Focus On Fair Lending

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The Consumer Financial Protection Bureau recently issued its fifth "Fair Lending Report"[1] summarizing the bureau's 2016 supervision and enforcement activity, rulemaking, interagency coordination and collaboration, and outreach to industry, advocates and consumers on fair lending compliance. Importantly, the report identifies markets, products and institutions the CFPB deems to represent the greatest fair lending risk for consumers.

Over the past five years, that focus has been increasingly on ensuring consumers are not excluded from or made to pay more for mortgages, indirect auto loans and credit cards. According to its report, the CFPB promises to remain committed to fair lending compliance in all credit markets, and irrespective of the present political climate, plans to increase its focus in the coming years on three areas: redlining, mortgage and student loan servicing, and small-business lending. As such, institutions should proactively use these focus areas as guideposts in developing their internal review processes for the coming year and be prepared to address these topics in their next compliance examinations.

2016 Regulatory Focus
In 2016, the CFPB continued to actively oversee and enforce compliance with fair lending and reported its fair lending supervisory and public enforcement actions resulted in approximately $46 million in remediation to allegedly harmed consumers. The bureau focused on mortgage lending and redlining risks, including whether differential lending patterns suggested lenders intentionally discouraged prospective applicants in minority neighborhoods from applying from credit. These activities culminated in a record consent order with Hudson City Savings Bank. As part of the Hudson City consent order, the CFPB introduced the new enforcement trend of focusing on an institution's applications, not just originations, and a move away from positively considering purchased loans in the fair lending analysis. The CFPB's 2016 redlining activities also highlighted that the CFPB is using creative methods to ferret out potential discrimination. Indeed, as part of the 2016 BancorpSouth consent order, the CFPB used "mystery shoppers" in its joint investigation with the DOJ to visit bank branches and inquire after mortgages in order to flesh out potential evidence of discrimination.

The CFPB's enforcement efforts in the indirect auto lending space over the last few years has covered more than 60 percent of the auto loan market share by volume, including notable consent orders with Ally Bank, Fifth Third Bank and American Honda Finance Corporation. These activities continued in 2016 with a sizable consent order with Toyota Motor Credit Corporation. These enforcement actions focused on the interest rates quoted by the lender to the dealer (buy rates) and the discretionary mark-up or adjustments to the buy rate by the dealer. Through these consent orders, the CFPB has sought to regulate the indirect auto lending market by pushing lenders to impose lower dealer reserve caps (set at 125 basis points

(1.25 percent) for contracts with term of 60 months or less, and 100 basis points (1 percent) for contracts longer than 60 months in the Toyota consent order), or eliminating dealer reserve entirely by pushing lenders to move to flat-fee models.

In 2016, the CFPB also continued to monitor the credit card market, focusing on compliance management systems (CMS) and fair lending risks in underwriting, line assignment and servicing.

2017 Regulatory Focus
The CFPB has given no indication it plans to slow its pace in overseeing and enforcing fair lending compliance in 2017. On the contrary, in the coming year, the CFPB announced it will continue to focus on its goals of strengthening industry compliance programs, rooting out illegal activity, and ensuring harmed consumers are remediated. The CFPB further stated it will focus on the markets and products that it views as presenting a substantial risk of credit discrimination for consumers: redlining, mortgage and student loan servicing, and small-business lending.

Redlining
According to the report, the CFPB will increasingly scrutinize redlining and whether lenders have intentionally avoided lending in minority neighborhoods. In assessing redlining risk, the CFPB will continue to review the recently-expanded Home Mortgage Disclosure Act and census data to assess an institution's lending patterns for discrimination. The CFPB will also review other factors including, but not limited to, the strength of an institution's CMS, geographic attributes, peer and market comparisons, physical presence, marketing, and an institution's explanations for apparent differences in treatment.

The U.S. Department of Justice's recent redlining complaint against Kleinbank, filed in January of 2017, is likely indicative of the CFPB's ever-expanding approach in this area. Notably, in that action, the DOJ filed suit against Kleinbank without a referral from the bank's primary regulator. Instead, the DOJ drew its own conclusions from a statistical analyses of the bank's applications and originations, presumably based on the bank's reported HMDA data. Even more troubling, however, instead of focusing on the bank's delineated Community Reinvestment Act (CRA) assessment area, the DOJ crafted a new "Proper Assessment Area" for the bank that included the areas that the DOJ believed should have been included based on "comparable" lenders. In other words, institutions can no longer rely on their delineated CRA assessment areas for conducting their redlining analyses, but instead must proactively conduct peer and market comparison to derive the "Proper Assessment Area" that may be imposed by regulators.[2]

Mortgage and Student Loan Servicing
The CFPB also stated in its report that it will focus on protecting consumers from credit discrimination and broadening access to credit. In particular, mortgage and student loan servicers should expect increased scrutiny on whether creditworthy consumers have equal access to loans. The CFPB further stated it will increase its focus on evaluating whether some borrowers, falling behind on payments, may have more difficulty working out a new solution with their servicer because of their race, ethnicity or age. This focus was recently exemplified by the CFPB's filing suit against the nation's largest servicer of both federal and private student loans in January of 2017 and the country's largest nonbank mortgage loan servicer in April of 2017.

Small-Business Lending
The CFPB also announced it will increase its focus on promoting fair credit access for minority and women-owned businesses. According to the report, Congress has required the CFPB to ensure fair

access to credit and expressed concern that women-owned and minority-owned businesses may experience discrimination when they apply for credit. In response, the CFPB stated small-business lending supervisory activity will help expand and enhance the bureau's knowledge in this area, including the credit process, existing data collection processes, and the nature, extent and management of fair lending risk.

Industry Response

The CFPB's prioritization of potential fair lending harm has been met with mixed responses from the industry. The American Bankers Association (ABA), for example, criticized federal agencies' use of the disparate impact theory to "brand banks with violations of fair lending rules."[3] The ABA noted that lenders, in examining enforcement actions applied to other institutions, now seek to collect extensive data, run sophisticated statistical analyses, and apply "questionable proxy methodologies" in an effort to identify policies or practices that a regulator might deem to have a disproportionate negative effect on a protected group. According to the ABA, the application of vague fair lending enforcement theories undermines a primary goal of the fair lending laws — to expand credit opportunity and availability — and that "[w]here the costs or regulatory risks of the new enforcement and compliance theories are high, or lenders are unable to discern from enforcement actions what is expected, lending becomes more standardized and defensive, less tailored and some programs or services are discontinued."

The resulting impact, according to the ABA, has been significant on all banks but especially on community banks, "whose comparative advantage in tailoring loans to local borrowers is damaged." Indeed, we have seen this result borne out in practice, with many community banks reducing, or eliminating entirely, certain small loan products, mortgage and indirect auto lending lines when faced with the ever-increasing compliance risks and costs.

The ABA also criticized the CFPB's announcement that small-business lending will be a fair lending priority in 2017, citing the lack of clarity on how the bureau will define a small business, whether the CFPB will apply proxies in the absence of information about race, ethnicity or gender of the small-business owner, and whether the CFPB will evaluate small-business lending under a disparate treatment or disparate impact theory. According to the ABA, the "HMDA-like data collection and reporting obligation has the potential to change small business lending dramatically, increasing the cost and limiting the availability of credit to small businesses, a key engine of growth and job creation in the U.S. economy." Instead, the ABA proposes regulatory reforms that would focus enforcement on illegal intent to violate fair lending standards, to recognize bank efforts to meet local needs, and to keep the CFPB's focus on consumers, not businesses.

Takeaways

Despite industry criticism, absent regime change, the CFPB's report suggests it will continue to charge ahead on overseeing, enforcing and even expanding fair lending compliance in 2017. In today's regulatory environment, institutions must have robust policies and procedures in place to ensure fair lending compliance in all credit markets. In particular, now that the CFPB has made clear its regulatory focus for the coming years, it is essential that institutions proactively address fair lending risks in redlining, mortgage and student loan servicing, and small-business lending, as these areas will certainly be scrutinized in the next examination cycle.

Institutions should also take care that their practices are not perceived as discouraging prospective applicants in minority neighborhoods from applying for credit, particularly when compared to their peers, that borrowers who are behind on their mortgage or student loan payments do not have more difficulty obtaining a work-out solution because of their race, ethnicity or age, and that women-owned and minority-owned small businesses do not experience discrimination when they apply for credit.

[1] https://www.consumerfinance.gov/documents/3654/201704_cfpb_Fair_Lending_Report.pdf

[2] The Federal Reserve Board has adopted the concept as "Reasonably Expected Market Area."

[3] http://www.aba.com/Compliance/Documents/FairLendingWhitePaper2017Apr.pdf. method of paying for government, which allowed property taxes to increase dramatically year to year, often resulting in senior citizens on fixed incomes being unable to afford to stay in their homes. On top of cutting and restricting increases in property taxes, Prop 13 contained language requiring a two-thirds majority in both legislative houses for future increases of any state tax rates or amounts of revenue collected, including income tax rates and sales tax rates.

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