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Fair Lending and Servicing Practices Face Deeper Scrutiny Under New Administration

New presidential administrations often establish new demands and priorities with regard to addressing and enforcing current regulations based on their own priorities. The latest change in the White House, with the Biden administration assuming control, has been no exception. Whereas the Trump administration scaled back enforcement of financial regulations in a number of areas, including but not limited to fair lending and servicing practices, the Biden administration, as expected, is setting a different tone.

What does this mean? Financial institutions can expect much greater attention paid to enforcement of numerous financial regulations, especially fair lending and servicing practices. While these areas should always have been considered a priority for lenders, the current administration has pledged to increase scrutiny and oversight, which puts financial institutions under pressure if they are not being rigorous and thorough in their compliance with current fair lending regulations and guidelines.

With regard to fair lending regulations, following is a summary of developments and potential changes on the horizon for the financial services industry. Granted, some of these may not come to fruition in the short term, if ever. Still, it is vital for financial institutions to be mindful of current regulations and regulatory posture and ensure that their practices, methodologies and controls are in full compliance. The one thing of which there is little doubt is that the current administration and its newly appointed agency leaders will be watching industry adherence to fair lending requirements very closely.

Presidential memorandum on redressing discriminatory housing practices and policies

Less than a week after taking office, President Biden issued a memorandum reinforcing the policy of the administration to "… work with communities to end housing discrimination, to provide redress to those who have experienced housing discrimination, to eliminate racial bias and other forms of discrimination in all stages of home-buying and renting, to lift barriers that restrict housing and neighborhood choice, to promote diverse and inclusive communities, to ensure sufficient physically accessible housing, and to secure equal access to housing opportunity for all."[1] The memorandum also states:

> *The Federal Government must recognize and acknowledge its role in systematically declining to invest in communities of color and preventing residents of those communities from accessing the same services and resources as their white counterparts. The effects of these policy decisions continue to be felt today, as racial inequality still permeates land-use patterns in most U.S. cities and virtually all aspects of housing markets.*

As directed under this memorandum, the Secretary of Housing and Urban Development is instructed to undertake numerous actions to eliminate discrimination and bias in housing practices, which certainly includes fair lending policies in the financial services industry. This portends greater scrutiny and regulatory oversight of lenders.

A proposed National Homeowner and Renter Bill of Rights

During his presidential campaign, Joe Biden pledged to invest $640 billion over 10 years to provide every American with access to affordable housing, located near good schools and within a reasonable commute to their jobs.[2] A proposed Homeowner and Renter Bill of Rights, modeled on the California Homeowner Bill of Rights, would advance President Biden's agenda by giving homeowners a private right of action to seek financial redress from mortgage lenders and servicers that violate certain protections.

This plan would amount to a clean break from the past. It would roll back Trump administration policies that gutted fair lending and fair housing protections for homeowners, and particularly the dismantling of the Office of Fair Lending within the Consumer Financial Protection Bureau (CFPB). It also would advance consumer protection measures that stalled in the last four years of the Obama administration. Of note, while these potential developments have some Democratic support and would mean increased and more detailed oversight of financial institutions, it is unlikely that meaningful legislation on this issue will be able to pass through the current Congress.

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[1] "Memorandum on Redressing Our Nation's and the Federal Government's History of Discriminatory Housing Practices and Policies," The White House, January 26, 2021: www.whitehouse.gov/briefing-room/presidential-actions/2021/01/26/memorandum-on-redressing-our-nations-and-the-federal-governments-history-of-discriminatory-housing-practices-and-policies/.

[2] "The Biden Plan for Investing in Our Communities Through Housing," Biden-Harris Campaign: https://joebiden.com/housing/.

LGBTQ+ protections

Another area of regulatory focus relates to lending and credit decisions for LGBTQ borrowers. The CFPB recently released an interpretive rule expanding the protections under the Equal Credit Opportunity Act (ECOA) that will now cover LGBTQ+ Americans, a move that allows the federal government to investigate complaints of housing discrimination based on sexual orientation or gender identity.[3] This rule came about from an executive order signed by President Biden.

Legacy protected classes, either via the Fair Housing Act or ECOA, did not originally include the LGBTQ+ community. With the CFPB's latest interpretive ruling, fair housing is no longer based only on a traditional definition of discrimination against prohibited bases (e.g., sex), but now also includes the applicant's sexual orientation or gender identity.

Potential government competitor to credit reporting agencies

The three legacy credit reporting agencies – Equifax, TransUnion and Experian – also are in the crosshairs of the Biden administration as part of its fair lending agenda. Because any type of major loan requires a credit score as part of loan repayment screening by the lender, there are regulations that govern how financial institutions communicate with the credit agencies and update credit scores.

However, many believe the rules (such as requirements on timing) are inconsistent. The Fair and Accurate Credit Transmissions Act of 2003 (FACTA), which amended provisions from the Fair Credit Reporting Act (FCRA), established additional guardrails, such as notification and adjusting a credit score when in dispute, but it is still difficult for banking institutions to get it right. Critics of the current credit reporting system argue that it holds consumers back from becoming homeowners due to problems like credit reporting errors and unfair, biased methodologies for assigning credit scores that tend to disadvantage minority groups with inadequate credit history. In an effort to address these issues, the administration is considering creating a public credit reporting agency (CRA) to compete with the three major credit bureaus and possibly one day replace them altogether.

In our view, the plan to establish such an agency, which would be housed within the CFPB, will have significant implications for the financial services industry but it will not solve the limited credit access to marginalized communities. A new body design does not fix a faulty engine. Even with a new agency, there will be the challenge of requiring banks to report on time, update credit scores and manage the volume of disputes so consumers have a reasonably accurate credit score to obtain a loan. Improved minority access to credit will still be hampered by limited credit-building activities. As such, many experts argue that if the Biden administration is looking to

[3] "CFPB Clarifies That Discrimination by Lenders on the Basis of Sexual Orientation and Gender Identity Is Illegal," Consumer Financial Protection Bureau, March 9, 2021: www.consumerfinance.gov/about-us/newsroom/cfpb-clarifies-discrimination-by-lenders-on-basis-of-sexual-orientation-and-gender-identity-is-illegal/.

solve access to credit for marginalized communities, a new CRA may not be the best answer – and could in fact make matters worse. The best way forward is for the administration and banks to review baseline governing regulations and develop policies that would better guarantee fair and equitable access to credit for underserved communities.

Details on exactly how a public CRA would work remain scarce. And it is not clear whether the administration will be able to move quickly with this plan given its long list of priorities (e.g., infrastructure and immigration). Still, lenders should monitor developments of this proposal to understand, if the proposed agency moves forward, how it impacts existing credit products and services.

A reinvigorated Consumer Financial Protection Bureau

The Biden administration's CFPB, under presumed incoming director Rohit Chopra, is expected to increase its focus on and enforcement of traditional fair lending concerns (e.g., redlining, judgmental underwriting), as well as emerging lending issues that may arise from the use of new technologies for underwriting, pricing, collections and other purposes. In Volume II of its Taskforce on Federal Consumer Financial Law Report, published in January 2021, the bureau notes that "new technologies and methods such as artificial intelligence (AI), machine learning (ML), and the use of alternative data are rapidly evolving to better serve customers." In the report, the bureau also states that, with regard to these technologies and alternative data, "institutions who do not wish to be sanctioned … will strive to reduce discrimination and algorithmic bias while also investing in tools to explain their outcomes to regulators when they are examined for compliance with fair lending law."[4]

The CFPB has also communicated its intention to focus on providing relief for consumers. Specifically, in his January 28 statement to all CFPB staff, acting Director Dave Uejio noted that the bureau's priorities are "(1) relief for consumers facing hardship due to COVID-19 and the related economic crisis, and (2) racial equity." Uejio cited a number of instances throughout the financial services industry where "companies are failing to properly administer relief through the crisis."[5] These areas of focus are expected to remain priorities under presumed incoming director Chopra.

Furthermore, as expected, the CFPB is planning to reverse policies of the prior administration that weakened enforcement and supervision. There is little doubt that the CFPB is positioning itself to increase its regulatory oversight activities. Traditionally, a regulator examines an institution, identifies issues of concern and then, if violations are confirmed, considers further

[4] *Taskforce on Federal Consumer Financial Law Report, Volume II*, Bureau of Consumer Financial Protection, January 2021: https://files.consumerfinance.gov/f/documents/cfpb_taskforce-federal-consumer-financial-law_report-volume-2_2021-01.pdf.

[5] "The Bureau is taking much-needed action to protect consumers, particularly the most economically vulnerable," Dave Uejio, Consumer Financial Protection Bureau, January 28, 2021: www.consumerfinance.gov/about-us/blog/the-bureau-is-taking-much-needed-action-to-protect-consumers-particularly-the-most-economically-vulnerable/.

actions such as civil money penalties or even a criminal referral. The CFPB's expected posture, modeled after that in place when the agency was first stood up, is likely to begin with investigations in anticipation of finding issues. The bureau has ramped up attorney recruitment significantly this year, a clear sign it will pursue more aggressive oversight and enforcement.

While all financial institutions should expect their fair lending and servicing activities to come under greater scrutiny, the regulatory spotlight will be much brighter on firms with assets in the $10 billion or more range. Community banks with less than $10 billion in assets but still operating under CFPB examination will also be affected, given that some may not be as familiar with fair lending and servicing requirements or may not have in place the same stringent compliance management systems that larger sophisticated institutions use.

How banks and fintechs should respond now

While FICO scores are critical to lenders in assessing the likelihood of being repaid, it cannot solve inherent bias or systemic inequities in access to credit for marginalized communities. For instance, with big data and Bayesian Improved Surname Geocoding (BISG) proxy, the CFPB has a standard methodology for proxying for race, ethnicity and gender. Leading questions during the application process that appear benign or standard, such as an applicant's first and last name, FICO score range, and property ZIP code, can be proxied for race, ethnicity, gender and census tract information – all of which can then be used to determine whether the home is in a "desirable" neighborhood.

Managing fair lending risk must go beyond the obvious answers of FICO scores and government sponsored enterprise (GSE) guidelines. There is far too much information available to not manage fair lending risk upstream and downstream. The renewed focus on lending discrimination means financial institutions need to review their use of FICO scores and other lending criteria carefully. They should reexamine how they are modeling specific lending products and their impact on minority communities.

Of note, fintechs are not subject to fair banking requirements, but they present many of the same types of fair lending risks present in traditional banking, including underwriting discrimination, pricing discrimination and redlining. In the past, the CFPB has shown a willingness to bring claims against lenders for unfair, deceptive, or abusive acts or practices (UDAAP) under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Going forward, it is important that fintechs increase their fluency with fair lending and UDAAP concepts so they can integrate these into their consumer protection considerations and ensure effective compliance. The Biden administration and the CFPB have indicated that fintechs will garner greater attention under their regulatory and oversight radar.

Fintechs should assess whether any of their products or services increase fair lending or UDAAP risks or continue the borrower's cycle of debt. They also should consider this key question: *What part of what we provide could be unfair, deceptive, or abusive acts or practices – the whole fairness concept that CFPB enforcement hinges on?* Keep in mind that the fairness concept is difficult to define. Even firms with the best intentions have faced multimillion-dollar penalties by making the wrong assessment.

In closing

Given the greater regulatory scrutiny coming their way, financial institutions will need to connect the dots and be able to affirm that their lending activities have no disparate impact. Bank leaders should be able to state confidently that they did not overtly or accidentally discriminate. Careful monitoring, which begins at inception of a product or service in the first line, through the second line compliance function and the third line internal audit function, is critical.

About Our Financial Services Industry Practice

Disruptive technologies, evolving customer loyalty and pressure to enhance economic returns define just some of the challenges financial services organizations need to overcome by innovating and managing risks in order to succeed over the next decade. The dynamic regulatory landscape and increased emphasis on cost reduction only adds to the complexity of financial services organizations achieving profitable growth.

Protiviti's global financial services team brings a blend of proven experience and fresh thinking through a unique 50/50 mix of "home grown" talent combined with former industry professionals, including risk and technology executives, commercial and consumer lenders, compliance professionals, and financial regulators.

As a major global consultancy, we have served more than 75% of the world's largest banks, many large and midsized brokerage and asset management firms, and a significant majority of life as well as property and casualty insurers, solving our clients' issues across all three lines of defense of the business to meet the challenges of the future, today.