PRICEWATERHOUSECOOPERS

FS Regulatory Brief

How Might the CFPA Impact Fair Lending Enforcement?*

The proposed Consumer Financial Protection Agency ("CFPA" or "Agency") Act of 2009 represents the Obama administration's proposal to strengthen consumer protection and oversight in response to the recent financial crisis. While policymakers in Congress are expected to make a number of changes to the administration's proposed legislation before it becomes law, there are lessons to be learned from the administration's proposal in terms of the direction of future fair lending enforcement.[1] As proposed, the Act would create vast changes in the regulatory landscape — subjecting previously unsupervised consumer lenders to federal supervision, changing compliance requirements for currently supervised consumer lenders, and paving the way for states to enforce laws that were previously preempted in order to provide the highest level of consumer protection. The CFPA would be transferred authority for a number of consumer protection regulations from the existing federal agencies. Among those potentially being transferred is the Equal Credit Opportunity Act ("ECOA") and the Home Mortgage Disclosure Act ("HMDA") — both of which have potential fair lending implications for all institutions that would be regulated by the Agency.

Numerous summaries of the proposed CFPA have already been produced and, therefore, the focus of this brief is on the potential fair lending implications of the proposed CFPA Act of 2009 and what financial institutions should consider in preparing for future CFPA fair lending oversight.

[1] See, in addition, the July 2009 Government Accountability Office report to Congress, "Fair Lending: Data Limitations and Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts."

Potential Impacts to All Consumer Lenders

The CFPA Act of 2009 proposes two important changes to consumer loan application information collection and disclosure requirements:

- **Home Mortgage Disclosure Act** ("HMDA") — the proposed CFPA Act would expand non-exempt institution's HMDA loan application disclosures to include, for the first time, the following additional loan and transaction characteristics:
  - Total points and fees payable at origination in connection with the mortgage
  - Term of the mortgage loan
  - Prepayment penalty term
  - Property value (presumably to allow for the calculation of loan-to-value ratios)
  - Teaser-rate term
  - Indicator as to whether the mortgage has a non-fully amortizing monthly payment
  - Loan origination channel (e.g., retail, wholesale, etc.)
  - Loan originator identification code
  - Credit score

Not only will these additional disclosure requirements require changes in data collection and retention practices, but they will also provide third parties — including federal and state regulators, consumer advocacy groups, class action attorneys, media outlets, etc. — with much more detailed transaction data to evaluate potential fair lending issues for all non-exempt financial institutions.

For lenders who currently test their loan application and origination data for potential fair lending risks (for example, through regression analysis), these additional disclosure requirements may suggest the need for certain modifications to their fair lending testing procedures. Alternatively, for lenders not currently performing such tests, the disclosure of this data increases the likelihood that potential fair lending issues may be identified by third-parties. As

such, designing and implementing a fair lending testing program may help such institutions identify these potential issues proactively and take appropriate corrective actions.

- **Equal Credit Opportunity Act** ("ECOA") — the proposed CFPA Act would also require, for the first time, lenders to collect information on the race and ethnicity of the principal business owners associated with a small business loan application.

  Clearly, this proposed requirement would provide the loan-level demographic information necessary to evaluate more effectively potential discrimination in the underwriting and pricing of small business loans. For institutions engaged in such lending, not only are new operational procedures required for the collection and retention of this new data, but changes in fair lending programs may also be needed to incorporate this data into a more effective fair lending monitoring process.

Potential Impacts to Federally-Supervised Consumer Lenders

Although federally-supervised institutions already have experience with federal fair lending examination procedures, the merger of the various federal agencies' fair lending examination resources into the CFPA creates some interesting potential changes. For example,

- Fair lending examination procedures implemented by the CFPA could become more rigorous for some lenders as the multi-agency specialists draw upon the best practices of each agency to create a more uniform examination process

- The views of the CFPA fair lending examiners on certain matters may differ importantly from the views of a lender's current supervisor. For example, presently there is some diversity of views in the following areas
  - A lender's responsibility for decisions of third-party originators
  - Acceptable non-discriminatory regression model variables
  - The reasonability of certain fair lending testing procedures
  - The reasonability of certain corrective action procedures

At a minimum, lenders may wish to evaluate how their existing fair lending compliance risk management program might fare under a more rigorous examination process and consider enhancements to areas of their programs that may raise regulatory concern under a "multi-agency" CFPA fair lending examination approach.

Potential Impacts to Non-Federally Supervised Consumer Lenders

For non-bank consumer lenders not subject to previous federal supervision, the impact of the proposed CFPA is likely more significant. Due to the absence of prior fair lending examinations, the rigor and/or formality of these institutions' fair lending programs is likely below that of their federally-supervised peers. There may also be elements of their current fair lending programs that do not currently meet both the formal and informal expectations of the federal bank regulatory agencies.

In anticipation of CFPA oversight, such lenders may wish to assess the following areas of their existing fair lending programs to identify areas of potential enhancement:

- **Risk assessment process** — designed to periodically assess the fair lending risk associated with the institution's products, services, and practices.
- **Policies and Procedures** — serve to enumerate the institution's commitment to fair treatment of customers and that allow the institution to prevent, detect, and correct instances of unfair treatment. Policies and procedures should typically address the following areas of fair lending risk:
  - New Products/Services
  - Advertising, Marketing, and Solicitation
  - Credit Policy
  - Sales and Pricing Practices
  - Loan Servicing
  - Compensation Practices
  - Referrals
  - Third Party Originators

- **Organization and/or committee structure** — provides for the accountability and oversight of the institution's fair lending program.
- **Training**, tailored according to roles and responsibilities, which informs employees of fair lending requirements.
- **Monitoring and testing program** — including regression analysis — that evaluates transactions for areas of potential discrimination in underwriting decisions or pricing practices.
- **Model validation process** — ensures that applicable credit scoring and/or automated underwriting systems are empirically derived and statistically sound.
- **Change management function** through which changes to fair lending laws, regulations, and regulatory guidance are tracked and pushed out to relevant parties for implementation.
- **Complaint management process** — channels complaints that allege discrimination or contain other fair lending concerns to the group(s) responsible for fair lending compliance for review and corrective action.
- **Audit program** — reviews the design and operating effectiveness of the fair lending program on a periodic basis.

Conclusion

Although the regulatory restructuring bill that includes the CFPA has not yet been passed, it is anticipated that Congress will pass it prior to year end. As such, institutions should be proactively reviewing and improving their current compliance risk management programs, including fair lending compliance, to prepare for increased consumer protection oversight by the Agency.

Even if the CFPA is not created, however, the focus on consumer compliance, including fair lending, will continue to increase by existing federal and state bank regulatory agencies, state attorneys general, class action attorneys, and consumer advocacy groups as a result of the political fallout from the financial crisis. As a result, investing in enhancements to compliance risk management programs today will likely reduce your institution's legal, compliance, and reputational risks in the near future.

Additional Information

If you would like additional information about the topic discussed in this FS Regulatory Brief or advice related to your specific fair lending compliance risk management program please contact:

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