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*Practice Group:**Consumer Financial Services*

CFPB Fair Lending Updates – Expectations for Enforcement and Regulation in 2013

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Signaling that 2013 will be another eventful year in the fair lending world, the Consumer Financial Protection Bureau (“CFPB” or “Bureau”) issued two items this month that reveal an ambitious agenda for fair lending enforcement and regulation. On December 6, the Bureau entered into a Memorandum of Understanding¹ (“MOU” or “Agreement”) with the Department of Justice (“DOJ” or “Department”) describing how the two agencies will coordinate their fair lending enforcement efforts. On the same day, the CFPB published its first Fair Lending Report,² detailing the Bureau’s fair lending efforts to date and outlining its upcoming plans.³ The Report explains that the Bureau is “still in the process of building [its] fair lending program” but emphasizes that fair lending is—and will continue to be—a top priority.

MOU between the CFPB and the DOJ Regarding Fair Lending Coordination

The December 6 MOU between the CFPB and the DOJ outlines the mechanisms for: (1) interagency information sharing and confidentiality; (2) joint investigation and coordination, and; (3) referrals between the agencies. Consistent with Dodd-Frank Act⁴ Section 1052, which specifically authorizes the Bureau to engage in joint fair lending investigations with both the Department of Housing and Urban Development and the DOJ, the Agreement reiterates the CFPB and the DOJ’s commitment to sharing information in furtherance of coordinated fair lending enforcement and joint investigations under the Equal Credit Opportunity Act (“ECOA”). The Agreement contains relatively detailed confidentiality undertakings and provides that disclosures of information between the agencies will not constitute public disclosure or a waiver of confidentiality, work product doctrine or any other applicable privileges. Although interagency information sharing is not uncommon, some entities have been wary of turning over privileged information and documents to the CFPB without the assurances of a statutory amendment.⁵ Recently, both houses of Congress passed a bill that would amend the Federal Deposit Insurance Act to include the CFPB in the list of regulators with whom a regulated entity may share privileged information without waiving the privilege.⁶ President Obama is expected to sign the bill into law.

With regard to joint investigations, the CFPB and the DOJ agree to meet at least quarterly to discuss current fair lending investigations within the purview of both agencies. The MOU provides that the agencies “will strive to avoid unnecessarily duplicative actions,” but emphasizes that the Agreement will not affect either agency’s independent authority to proceed in the manner it deems appropriate.⁷ The Agreement also outlines procedures for interagency referrals. Consistent with the ECOA statute and the CFPB’s Supervision and Examination Manual, the CFPB agrees to refer a matter to the DOJ if the CFPB has reason to believe that a creditor has engaged in a pattern or practice of discouraging or denying applications for credit in violation of ECOA.⁸ Although not required by ECOA, the CFPB also agrees in the MOU to refer to the DOJ *all* matters (*e.g.*, matters involving loan pricing) where it has reason to believe that a creditor engaged in a pattern or practice of lending discrimination. After the CFPB refers a matter, the Department will make reasonable efforts to determine within 60 days

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whether it will investigate the matter further.⁹ The Agreement also reiterates the CFPB’s discretionary authority to notify the DOJ of possible violations of other statutes under the enforcement jurisdiction of the DOJ, including the Fair Housing Act and the Servicemembers’ Civil Relief Act.¹⁰ Finally, the MOU states that the DOJ may, in its discretion, notify the CFPB when the DOJ has reason to believe that a creditor violated ECOA or has information that may be relevant to potential violations of other statutes enforced by the CFPB, including the Home Mortgage Disclosure Act (“HMDA”).

MOUs between federal agencies for areas of joint jurisdictions are not uncommon and much of the language in the recent MOU is reminiscent of past agreements.¹¹ Although the agencies’ express intentions are to enhance the framework for fair lending coordination and to minimize regulatory overlap, in practice, the Agreement provides no specific benchmarks as to when coordination will occur or what practical steps the agencies will take to streamline the burden of joint investigations. In sum, the MOU lays out some framework for coordinated enforcement efforts between the Bureau and the DOJ and signals that the agencies are likely to step up their fair lending enforcement in the coming year.

Inaugural CFPB Fair Lending Report

On the same day it signed the MOU, the CFPB published its inaugural Fair Lending Report, which it also submitted to Congress to fulfill its statutory reporting requirements under Dodd-Frank, ECOA and HMDA. In the Fair Lending Report, the agency extolls its first-year accomplishments, including:

- Commencement of its fair lending supervision program, and completion of various levels of fair lending reviews at dozens of bank and nonbank institutions offering a variety of lending products;
- Commencement of its fair lending enforcement program, and initiation of fair lending investigations;
- Completion of an empirical study on the use of cohort default rates in private education lending; and
- Outreach to private industry as well as fair lending, civil rights, and consumer and community advocates through dozens of meetings and events in Washington, D.C. and across the country.¹²

In addition to highlighting past accomplishments, the Fair Lending Report details some of its behind-the-scenes efforts to build and implement a robust fair lending program and provides insights on the CFPB’s next steps in fair lending regulation and enforcement.

Supervision and Enforcement

In keeping with its strong focus on fair lending, the Bureau requires fair lending training as part of its new employee orientation program, and CFPB examiners are required to participate in an in-depth, two-week course on fair lending as part of their commissioning process.¹³ In addition, attorneys from the Bureau’s Office of Fair Lending provide briefings to regional examination teams covering fair lending issues discovered during examinations as well as fair lending topics and trends.¹⁴

In the Fair Lending Report, the CFPB indicates that it has examined “dozens” of both bank and nonbank entities, including some “in-depth” reviews of products or activities that may raise heightened fair lending concerns.¹⁵ As part of the supervision and examination process, the CFPB reiterates its focus on effective compliance management systems, and notes that it also expects to see “*fair lending* compliance management systems, which are adapted to the institution’s business strategy and operation.”¹⁶

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Common Fair Lending Violations

In the Fair Lending Report, the Bureau discloses the most frequently cited types of Regulation B violations found during the reporting period¹⁷ by Federal Financial Institutions Examination Council (“FFIEC”) agencies.¹⁸ Specifically, the most common types of alleged Regulation B violations were:

- Discrimination on a prohibited basis in a credit transaction (12 C.F.R. § 1002.4);
- Improperly requesting information in non-mortgage loans about race, color, religion, national origin, or sex (12 C.F.R. § 1002.5(b));
- Failure to collect information about mortgage loan applicants, including the applicant’s race, ethnicity, sex, marital status, and age, for monitoring purposes (12 C.F.R. § 1002.13(a) and (b));
- Failure to provide sufficient information, including specific reasons for adverse action, in the adverse action notification (12 C.F.R. § 1002.9(a)(2) and (b)(2)); and
- Improperly requiring a borrower to obtain the signature of a spouse or other person in order to be considered for credit approval (12 C.F.R. § 1002.7(d)(1)).¹⁹

During the reporting period, three of the FFIEC agencies also referred a total of twelve fair lending matters to the DOJ.²⁰ These referrals involved allegations of discrimination in credit transactions on the basis of race, national origin, age, or marital status.²¹ In addition to matters referred to the DOJ, the Fair Lending Report observes that the CFPB has “a number” of ongoing fair lending investigations, some of which were initiated independently and others of which are part of joint investigations.²²

Private Student Lending Study

The Fair Lending Report also contains an in-depth discussion of the fair lending aspects of the CFPB’s recent study on private student lending. In response to the mandate by the Dodd-Frank Act to examine private student loans, the CFPB collaborated with the Department of Education on the Private Student Loan Report (“PSL Report”)²³ submitted to Congress in July.²⁴ In the PSL Report, the CFPB expresses concern that the use of cohort default rates²⁵ in private student lending may raise fair lending issues because racial and ethnic minority students are concentrated disproportionately in schools with higher rates.²⁶ The CFPB, however, de-emphasizes the fact that the Department of Education also uses cohort default rates to determine an institution’s eligibility for federal student loan programs.²⁷ Based on the CFPB’s conclusory statements, it appears likely that the CFPB will target private student lending in its upcoming fair lending efforts.

The Fair Lending Report also outlines some next steps for the Bureau, which are discussed in greater detail below.

Next Steps in Fair Lending

Although the CFPB has already published interim final rules for Regulation B and Regulation C, Dodd-Frank mandates some additional changes that will have fair lending ramifications. Dodd-Frank requires the collection of specific additional fields for HMDA reporting purposes, and the Fair Lending Report states that the CFPB is currently considering whether to add other fields in its amendment of Regulation C under the Bureau’s discretionary authority.²⁸ These discussions are in the pre-rule stage, but we expect to hear more about these possible changes in the new year. Similarly, the Bureau indicates that it is still in the planning stage for promulgating the rules related to small, minority-, and women-owned business loan data collection and reporting that are mandated by Dodd-

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Frank.²⁹ Additionally, the CFPB is in the process of planning for promulgating regulations under TILA for abusive or unfair lending practices that promote disparities among consumers of equal creditworthiness but of different race, ethnicity, gender or age.³⁰

Overall, the inaugural Fair Lending Report is largely forward-looking—indicating that the CFPB is still in the process of building out its fair lending program—but its agenda is expansive and ambitious. In the words of the Bureau itself, “The CFPB’s work in the area of fair lending is a priority and has only just begun.”³¹

If you have any questions about the Bureau’s MOU with the DOJ, or its first annual Fair Lending Report, please call Melanie Brody, Paul Hancock or any other member of K&L Gates’ Consumer Financial Services Group.

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¹ Memorandum of Understanding between the Consumer Financial Protection Bureau and the United States Department of Justice Regarding Fair Lending Coordination (Dec. 6, 2012) [hereinafter DOJ MOU].

² Consumer Fin. Prot. Bureau, Fair Lending Report of the Consumer Financial Protection Bureau (Dec. 2012) [hereinafter Fair Lending Report].

³ It is also worth noting that the CFPB also published a Statement of Intent for Sharing Information with State Banking and Financial Services Regulators on December 6. As the title suggests, the Statement of Intent outlines the CFPB’s intentions to share information with state regulators, including, but not limited to: (1) coordination on nonbank examinations; (2) provision of nonbank examination reports; (3) access to consumer complaint information; (4) information concerning Registered Mortgage Loan Originators; and (5) provision of other agreed upon information, which may include enforcement-related information.

⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203.

⁵ For a detailed discussion of privilege waiver concerns as they relate to the CFPB, see Stephanie C. Robinson, “CFPB’s Guidance to Supervised Banks Says Privilege Waiver Concerns Are No Reason for Withholding Information” (Jan. 6, 2012), available at <http://www.consumerfinancialserviceswatch.com/2012/01/06/cfpb%E2%80%99s-guidance-to-supervised-banks-says-privilege-waiver-concerns-are-no-reason-for-withholding-information>.

⁶ H.R. Res. 4014, 112th Cong. (2012)(enacted).

⁷ DOJ MOU at 7.

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⁸ *Id.*

⁹ *Id.* at 8. The CFPB may extend the time for making a determination, or alternatively, may take any action that it “deems appropriate pursuant to its supervisory authority.” *Id.*

¹⁰ *Id.*

¹¹ *See, e.g.*, Memorandum of Understanding Between the Consumer Financial Protection Bureau and the United States Department of Justice (Jan. 20, 2012); Memorandum of Understanding Concerning the Sharing of Information Related to the Establishment of the Bureau of Consumer Financial Protection (May 26, 2011)(between the CFPB and the Department of Housing and Urban Development); Memorandum of Understanding Between DOJ and HUD Concerning Enforcement of the Fair Housing Act, As Amended By the Fair Housing Act Amendments Act of 1988 (Dec. 7, 1990).

¹² Fair Lending Report at 10.

¹³ *Id.* at 16.

¹⁴ *Id.* at 15.

¹⁵ *Id.* at 4.

¹⁶ *Id.* at 15 (emphasis in original).

¹⁷ The Fair Lending Report covers the period from July 21, 2011 through December 31, 2011. *Id.* at n. 1. Future reports will cover the entire calendar year.

¹⁸ The FFIEC agencies reporting include the CFPB, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration. *Id.* at 29.

¹⁹ *Id.*

²⁰ *Id.* at 30.

²¹ *Id.*

²² *Id.* at 17.

²³ Consumer Fin. Prot. Bureau, Private Student Loans: Report to the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Health, Education, Labor, and Pensions, the House of Representatives Committee on Financial Services, and the House of Representatives Committee on Education and the Workforce (Aug. 29, 2012).

²⁴ Dodd-Frank requires the examination of: (1) the underwriting criteria used by private educational lenders, including the use of cohort default rates; (2) whether federal regulators and the public have access to information sufficient to provide them with assurances that private education loans are provided in accord with the nation’s fair lending laws and that allows public officials to determine lender compliance with fair lending laws; and (3) any statutory or legislative recommendations necessary to improve consumer protections for private education loan borrowers and to better enable federal regulators and the

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public to ascertain private educational lender compliance with fair lending laws. Fair Lending Report at 22.

²⁵ The cohort default rate is “the percentage of each post-secondary school’s borrowers entering repayment on federal student loans in a particular two-year period who default prior to the end of that period.” *Id.* at 22.

²⁶ According to the PSL Report and the Fair Lending Report, many of the private student lenders studied limit loans to students attending schools with cohort default rates of between 6 and 12 percent, or less. African-American students attending public four-year schools were almost four times more likely than the general student population to attend schools with cohort default rates of greater than eight percent, and Hispanic students were more than seven times more likely to attend such schools. The CFPB thus stated that the “use of [cohort default rates] to determine loan eligibility, underwriting, and pricing may have a disparate impact on minority students by reducing their access to credit and requiring those minority students who do not meet the lenders’ eligibility thresholds to pay higher rates than are otherwise available to similarly creditworthy non-Hispanic white students at schools with lower [cohort default rates].” *Id.* at 23. While we believe that this application of disparate impact is flawed, the PSL Report reveals the direction in which the CFPB is headed.

²⁷ Specifically, when a school’s cohort default rates are above 25 percent in the last three years or 40 percent in the last year, the Department of Education will deem a school to be ineligible for federal student loan programs. Private student lenders use the school’s cohort default rate “as a proxy for a student’s likelihood of repaying debt.” The Bureau states that many lenders use cohort default rates to make school eligibility determinations, and some use them to make loan-level underwriting and pricing determinations. *Id.* at 21 and 22.

²⁸ *Id.* at 33.

²⁹ *Id.* at 26.

³⁰ *Id.*

³¹ *Id.* at 38.

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