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Financial Services

Regulatory Outlook: Fair Housing in the Biden Administration

The level of enforcement activity from the Consumer Financial Protection Bureau (CFPB) has decreased in recent years from over $12 billion in fines during the six-year tenure of the Obama-appointee Richard Cordray, to just $1.4 billion since Kathy Kraninger took over in 2018.[1] Recently, the Biden administration has selected a new CFPB Acting Director, Dave Uejio, signaling a shift in the agency's regulatory agenda, with heightened regulatory requirements in the housing market in the area of fair lending practices.

How should lenders examine fair lending practices in response to the CFPB's anticipated enforcement priorities?

Fair Housing and the Biden Plan

The current Biden plan on housing includes many fair lending components, including a $640 billion spend over the next 10 years to provide access to affordable housing, with a focus to end redlining and other discriminatory housing practices.[2] This may be driven by an increased scrutiny over financial institutions' lending practices and **disparate impact** standards where discrimination can be practiced (and challenged) without explicit intent—previously codified in 2013 under 24 CFR 100,[3] and significantly changed in 2019.[4] While some of these practices may have been reversed by the Trump administration, the Biden plan is clear on reversing those changes and increasing oversight over financial institutions.

Other components of the Biden housing plan are expected to increase oversight and change the regulatory environment for banks and other nonbank financial institutions, including the following:

- The implementation of the **Affirmatively Furthering Fair Housing** rule, which may require communities receiving certain federal funding to proactively examine housing patterns and revise discriminatory policies
- The establishment of national standards for housing appraisals to ensure adequacy of training and mitigating the risk of implicit biases for properties in minority areas that are assessed at less than their fair value
- Expand the **Community Reinvestment Act** (CRA) to be applicable to nonbank mortgage and insurance companies, and close several loopholes within the regulation that, according to former Office of the Comptroller of the Currency Comptroller Joseph Otting, allowed banks to obtain credit for activities that did not ultimately support moderate-income areas.[5] These proposed CRA modernization tasks to mitigate this include the creation of a publicly available list of CRA-qualifying activities and the establishment of a preapproval process for potential activities that will result in CRA credit[6]
- Enactment of a federal Homeowners Bill of Rights modeled after the version recently implemented in California that, among other priorities, prevents mortgage lenders from leading borrowers into loans that cost more than appropriate

These areas of focus are certainly not unique to the Biden plan. Otting has acknowledged that capital and lending hasn't flowed into communities in need at the required level, noting that a lot of former regulators have heard the same.[7] Federal Reserve Chairman Jerome Powell has repeated similar thoughts, saying in a June committee hearing that, "we are definitely recommitting ourselves to enforcement of fair lending laws."[8] This focus extends to Congress, as well, with the next chairman of the Senate Banking Committee, Sherrod Brown, recently proposing an agenda that seeks to improve housing and banking services for low-income Americans.[9]

1. Robert Schmidt and Jesse Hamilton,"Wall Street Frets Over a Revived CFPB Trump Left Toothless," Bloomberg, December 8, 2020, https://www.bloomberg.com/news/articles/2020-12-08/wall-street-frets-over-a-revival-of-cfpb-left-toothless-by-trump.
2. The Biden Plan for Investing in Our Communities Through Housing, https://joebiden.com/housing/.
3. Federal Register, Department of Housing and Urban Development, February 15, v2013, https://www.hud.gov/sites/documents/DISCRIMINATORYEFFECTRULE.PDF.
4. Federal Register, Proposed Rules, August 19, 2019, https://www.govinfo.gov/content/pkg/FR-2019-08-19/pdf/2019-17542.pdf
5. David Hood, "CRA update closes loopholes, enhances lending to low-income areas, Otting says," S&P Global, December 12, 2019, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/cra-update-closes-loopholes-enhances-lending-to-low-income-areas-otting-says-56110210.
6. Krista Shonk, "Three Takeaways from CRA Modernization," ABA Risk and Compliance, July 9, 2020, https://bankingjournal.aba.com/2020/07/three-takeaways-from-cra-modernization%E2%80%AF/.
7. See Footnote 5.
8. Rev, "House Financial Committee Hearing Transcript on Economy with Jerome Powell," July 17, 2020, https://www.rev.com/blog/transcripts/house-financial-committee-hearing-transcript-on-economy-with-jerome-powell.
9. Emily Flitter, "Next Senate Banking Chairman Sets Low-Income and Climate Priorities," January 12, 2021, https://www.nytimes.com/2021/01/12/business/banking-environment-housing-democrats-sherrod-brown.html.

How to Prepare for an Increased Fair Housing Focus

To prepare for a heightened fair lending regulatory environment under the Biden administration, there are steps that financial institutions should consider taking in the coming months.
These include:

1. **Fair lending Program.** Evaluate the current state of your fair lending activities and goals. A good starting point can be a fair lending risk assessment to evaluate across your organization:
   - The program's alignment with the organization's overall strategy and risk profile
   - Controls associated with fair lending requirements within the **Equal Credit Opportunity Act** and **Fair Housing Act** to measure the fair lending risks your organization faces
   - The alignment of the governance model to the experience, culture, size, and complexity of the organization, and where the fair lending program lies within this structure and other related processes with CRA and Home Mortgage Disclosure Act (HMDA) reporting
   - Re-examine policies and procedures between business units and centralized functions that support fair lending monitoring, and ensure the organization's activities cover all fair lending risk factors (e.g., steering risk, pricing, underwriting).

2. **Process of Collecting and Performing Fair Lending Data Analysis.** Implement data analysis techniques for continuous monitoring of disparities or outliers that may indicate discrimination under the **Disparate Impact Theory**. This can be completed through analysis of HMDA data against incomplete, withdrawn, and approved but not accepted applications, as well as other non-HMDA loan-level data. This could include data that would be relevant to all credit products, such as late fee-waiving decisions, performance of loans with add-on products, terms of loans, pricing and underwriting Bayesian Improved Surname Geocoding methodology.

   Triggered by the vast amount of data and proliferation of technological capabilities to process such volume, financial institutions have increased leveraging machine learning and artificial intelligence models in credit decision-making. However, exploiting such models is not a silver bullet to maintain a fair credit program, since such models are not immune to producing biased credit allocation. For example, such a model can exploit correlations that proxy for protected class, even within a framework where such information should be used in credit decisions.[10] In a totally different vein, the training data set through which the ML/AI implement learning, may have limited representativeness of the sample that is used in credit decisions.[11] Therefore, financial institutions should maintain a healthy skepticism of ML/AI output in credit-decisioning.

   a. Ensure that the processes associated with the request, retrieval, and delivery of fair lending data take into account different systems across business units and the availability of data being requested by compliance/the second line.

3. **Marketing and Digital Advertisement Efforts.** Evaluate your existing marketing strategy and processes across all credit products offered by your organization to identify any intent to discourage applicants on a prohibited basis. This includes targeted marketing strategies as well as indicators of digital redlining. Digital redlining is a relatively new risk that refers to the use of data analytics to target customer segments in an impermissible manner under the Equal Credit Opportunity Act and the Federal Housing Administration. This represents an emerging risk for banks, potentially resulting from algorithm-driven marketing as well as improper customer segmentation, regardless of intent. For example, Redfin was the subject of a recent lawsuit that alleged that it, in comparison to homes in primarily white neighborhoods, was less likely to offer realtor services, professional photos, virtual tours, online promotion or commission rebates for homes listed in majority minority neighborhoods as a result of its minimum pricing policy.[12]

10. Aaron Klein, "Reducing bias in AI-based financial services," Brookings, July 10, 2020, https://www.brookings.edu/research/reducing-bias-in-ai-based-financial-services/.
11. Jacob Kosoff and Eric Wilbrandt, "Don't let AI trigger fair-lending violation," American Banker, August 6, 2019, https://www.americanbanker.com/opinion/dont-let-ai-trigger-a-fair-lending-violation.
12. Gene Johnson, "Fair housing groups: Redfin 'redlines' minority communities," AP News, October 29, 2020, https://apnews.com/article/race-and-ethnicity-discrimination-lawsuits-seattle-real-estate-brokers-b834276621c7e604a1b03c8c142a0c6e.

4. **Fair Lending Compliance and Servicing Risk.** While much of the fair lending risk stems from originations, there exists substantial risks for servicers as well, particularly given the impacts from COVID-19. Some of these significant areas of risk include:
   - **Coronavirus Aid, Relief, and Economic Security Act Forbearances:** Permitted forbearance agreements are subject to Fair Housing Act requirements regarding discriminatory practices on prohibited basis factors, so it is important to mitigate any disparate impact throughout the offering and approval of these relief options. Note that the Department of Housing and Urban Development issued a release on February 11 that announced it will be extending enforcement of the Fair Housing Act to prohibit discrimination on the basis of sexual orientation and gender identity, so this is also an area to consider when evaluating any impermissible activities.[13]
   - **COVID-related refinancing and loss mitigation offerings:** Banks should consider including relevant data on refinancing/loss mitigation decisioning in fair lending analytics and pricing for holistic evaluation. The recently released January 2021 CFPB Supervisory Highlights includes commentary regarding multiple servicers that failed to properly offer home retention options to borrowers experiencing pandemic-related hardships.[14]
   - **Racial equity in housing access:** While much of the immediate compliance impact has been pandemic-related, expect additional focus on risks related to racial justice issues in the coming year. CFPB's Uejio recently published a memo in which he directed the CFPB's Division of Research, Markets, and Regulations to take steps that include:
     - Prepare an analysis on housing insecurity, including mortgage foreclosures, mobile home repossessions, and landlord-tenant evictions.
     - Prepare an analysis of the most pressing consumer finance barriers to racial equity to inform research and rulemaking priorities.
     - Explicitly include in policy proposals the racial equity impact of the policy intervention.[15]

   The results could likely include policies that expect banks to play a greater role in ensuring that all people, regardless of income, race, or ethnicity, have access to safe and affordable housing, so banks would be prudent to take all steps to ensure race places no barrier on housing access in the communities they serve.

While the full breadth of changes that President Biden will implement remains to be seen, the emphasis placed on fair lending during the campaign will likely result in a shift back toward the regulatory environment seen during the post-crisis Obama administration. Financial institutions should consider re-examining their fair lending programs for 2021 and beyond.

13. HUD.gov, "HUD to Enforce Fair Housing Act to Prohibit Discrimination on the Basis of Sexual Orientation and Gender Identity," February 11, 2021, https://www.hud.gov/press/press_releases_media_advisories/HUD_No_21_021.
14. Consumer Financial Protection Bureau, "Supervisory Highlights COVID-19 Prioritized Assessments Special Edition," Issue 23, Winter 2021, https://files.consumerfinance.gov/f/documents/cfpb_supervisory-highlights_issue-23_2021-01.pdf.
15. Dave Uejio, "The Bureau is working hard to address housing insecurity, promote racial equity, and protect small businesses' access to credit," CFPB, February 4, 2021, https://www.consumerfinance.gov/about-us/blog/the-bureau-is-working-hard-to-address-housing-insecurity-promote-racial-equity-and-protect-small-businesses-access-to-credit/.

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