Disclosure:

This podcast episode reflects the opinions of the hosts and guests and not of Greenberg Traurig, LLP. This episode is presented for informational purposes only, and it is not intended to be construed or used as general legal advice, nor solicitation of any type.

Intro:

Welcome to BigLaw Redefined, Greenberg Traurig Podcast discussing client focused legal news. The first episode addresses financial services industry trends and is hosted by Lisa Simonetti and guest Ben Saul.

Lisa Simonetti:

Thank you for joining the Financial Services Industry Trends Podcast. I'm Lisa Simonetti. I'm a shareholder based in Los Angeles and my practice is focused on consumer financial services litigation and enforcement proceedings, along with regulatory compliance. Today's guest is Ben Saul. Ben, please tell us a little bit about yourself.

Ben Saul:

Thanks, Lisa. I'm Ben Saul. I'm the shareholder in the DC office of Greenberg Traurig. I sit in the financial regulatory and enforcement group. And in that capacity, I cover lots of different things, but for purposes of our discussion and listeners today, two of them are the CFPB and Fair Lending and servicing specifically. Look forward to talking with you a little more about them.

Lisa Simonetti:

Great. Thank you, Ben. Let's start by discussing the Consumer Financial Protection Bureau and it's 2022 Fair Lending priorities. What issues do you think the bureau will put front and center?

Ben Saul:

The CFPB has been really clear that its primary priorities, putting Fair Lending aside, are to protect people harmed during the pandemic and to promote racial equity across the entire consumer finance ecosystem. As to the latter priority, a month ago, the bureau made headline news by announcing that it would leverage its UDAAP authority to police discrimination in connection with credit, as well as non-credit products alike amending its UDAAP exam manual accordingly.

Ben Saul:

I really can't understate the significance of this development. Truly sea change in anti-discrimination discrimination, supervision, and enforcement. But beyond this major new bureau initiative, when I think about some of the top 2022 Fair Lending priorities of the bureau and what they're likely to be, I look back to where the two priorities I mentioned earlier intersect.

Ben Saul:

Two subtopics that I think lie at this intersection, and this isn't going to surprise many of our clients, friends, and listeners here, are Fair Lending issues concerning the extension of small business credit and fair servicing issues, both in the mortgage and student loan servicing context. The CFPB's actions to date affirm my view and what I'm saying.

Ben Saul:

For example, even before the change in presidential administrations, the CFPB actively sought complaints from small businesses, which felt they had been discriminated against by lenders. New CFPB Director Rohit Chopra has prioritized completing the small business loan data collection rule making on the fair servicing front in promulgating guidance and amending the Real Estate Settlement Procedures Act or RESPA Regulation X in June 2021 to help prevent foreclosures, as borrowers have rolled off pandemic related moratoriums and forbearances.

Ben Saul:

The CFPB stated expressly that it expects servicers to ensure they comply with anti-discrimination laws in connection, for example, with loss mitigation and loan modifications. But the CFPB's 2020 Fair Lending scrutiny is going to extend well beyond these areas and include policing algorithmic bias and appraisal bias, as well as areas that have traditionally been of concern to regulators in the Fair Lending space like redlining, reverse redlining, relationship pricing and overlays.

Ben Saul:

Though not a focus area per se, I likewise expect the CFPB to pursue many of these claims aggressively under disparate impact theory reflecting a significant shift from the bureau's methodological approach during the Trump administration.

Lisa Simonetti:

That's a great overview and quite a bit for our clients to worry about, but can you focus more on the CFPB's expansion of its UDAAP authority to cover non-credit products? Can you explain exactly what has happened and what it means?

Ben Saul:

On March 16th, 2022, the bureau stated that it will now apply UDAAP scrutiny to all consumer finance products and services, regardless of whether they involve an extension of credit. The non-credit products and services that the bureau has identified as ones that it plans to prioritize during its examinations and for enforcement scrutiny include collections, servicing, consumer reporting, payments and remittances, and deposits.

Ben Saul:

The theory that the bureau plans to use is that anti-discrimination is "unfair." In amending the UDAAP exam manual concurrent with its announcement about this new use of UDAAP, the CFPB provided some examples of unfair discriminatory conduct. But that said, there are a lot of questions that remain unanswered, for example, which protected classes does UDAAP cover exactly, to what degree do clients need to monitor outcomes.

Ben Saul:

And for now, we're working with our clients to revamp their compliance management systems to ensure that they're managing for this new risk by amending those policies and procedures, implementing appropriate training and otherwise conducting gap analyses to spot areas of discretion or other exposure points where discrimination could theoretically enter into their processes with respect to non-credit products in particular, but more generally as discussed earlier.

Lisa Simonetti:

These are very important concrete steps to take in mitigating this risk. Now let's move on to another area of concern. I understand that in September of last year, the CFPB issued a 918 page notice of proposed rule making, which was long in the making, concerning creditor's obligations to collect data concerning extensions of credit to small business owners. What should our clients know in this area?

Ben Saul:

Okay. ECOA outlaws discrimination on a prohibited basis in "business credit transaction." To make it easier for potential discrimination to be uncovered, a section of the Dodd-Frank Act requires so-called covered financial institutions to collect data concerning whether a small business applicant is minority owned and/or women owned. Finally, it seems that the CFPB is going to push this issue forward and they have promulgated a notice of proposed rule making.

Ben Saul:

The scope of that is quite broad. The definition of covered financial institutions sweeps, as I say, broadly, covering not just banks, but also marketplace and online lenders and other known bank lenders that focus on making small business or commercial loans. Lots of these entities until now perhaps haven't thought as much about Fair Lending in comparison say to a mortgage lender who's been required for decades under the Home Mortgage Disclosure Act to provide similar data to the government.

Ben Saul:

The proposed rule clarifies financial institution's data collection requirements as well. I'll just sort of briefly try and tick through them. Under the proposed rule, a small business subject to the data collection requirement, it means a business that's got gross annual revenues under $5 million. For those businesses, the data collection requirement would apply to applications for loans, applications for lines of credit applications, for credit cards, and applications for cash advances.

Ben Saul:

A minority owned business is one for which over half of the ownership is controlled by or half of the net profits or losses go to one or more minority individuals. A woman owned business also tracks this same definition as minority owned, meaning that a woman owned business is characterized by ownership greater than 50% or profits and loss is greater than 50% owed to one or more women in the enterprise.

Lisa Simonetti:

Ben, that's who is covered, but what must a covered financial institution collect concerning these small businesses under the proposed rule? Who would have access to that data and how would it be reported?

Ben Saul:

Under the proposed rule, the covered institution needs to collect information concerning the ownership demographics of the small business, but applicants can refuse to provide it. It's important that financial institutions maintain the application data separately from information concerning the credit decisioning process. Underwriters, for example, can't have access to the data to prevent any bias from weighing on the credit decisions that they make.

Ben Saul:

Under the proposed rule, covered financial institutions have to report that data on a calendar basis by July 1st of each year. The proposed rule contemplates that public report will be issued annually and that the CFPB will issue a policy statement after it has collected, reviewed, and analyzed one full year of data. I think it's fair to expect that once this data is reported to the government, like with the Home Mortgage Disclosure Act, the CFPB and community groups are going to analyze it very carefully.

Ben Saul:

They're going to use it to prioritize scrutiny of entities that report data that suggests their small business lending decisioning and/or pricing practices lie outside the norm. And likewise, as with the HMDA data, community groups are going to mine it to support challenges to prevent bank acquisitions or branching expansions. As of now, what clients can do is try and influence the rule making, track its development, and concurrently start to get ready for their potential collection and reporting obligations.

Ben Saul:

I think maybe most importantly, start to understand what data they already have that tells them the composition of their small business lending portfolio and borrower base, as well as recent lending patterns to the same. And while I think scrutiny on commercial credit is going to accelerate greatly after the small business loan data collection rule making is completed and the rule becomes effective, the scrutiny is here no.

Ben Saul:

As our clients who are comprehensively examined by the federal banking regulators likely already know some clients that made PPP loans faced allegations in private lawsuits, as well as concerns expressed by regulators that their practices of, for example, prioritizing existing or larger customers over others are potentially violative of the Fair Lending laws. Beyond PPP lending, we're just seeing more aggressive, Fair Lending examination focus from the CFPB.

Ben Saul:

For sure, this is an area that clients should, if they're not already, be focused on in terms of allocating additional compliance resources in 2022.

Lisa Simonetti:

I completely agree. And now let's turn for a few minutes to fair servicing and mortgage loans and student loans. Earlier, you mentioned fair servicing as an anticipated risk area, and I can see how this is another way in which the dual priorities of protecting individuals impacted by the pandemic and Fair Lending intersect. Can you talk a little bit more about how this might play out in 2022?

Ben Saul:

Yes. I think as most of our clients who service loans know that fair servicing issues are not new. But as borrowers continue to exit a pandemic moratoriums and forbearance plans, the scrutiny, especially on mortgage servicers, is really increasing. As I mentioned earlier, in late April 2021, for example, the CFPB issued a bulletin in which it warned mortgage servicers to be ready for this current ongoing wave of borrowers requesting loss mitigation.

Ben Saul:

And then in June 2021, they finalized a rule amending RESPA and Regulation X to help stave off some of what the bureau termed in the rule making avoidable foreclosures. In doing this, the CFPB made clear to servicers that they're going to examine compliance with ECOA and specifically in the rule making called out, one, whether servicers are managing communications with limited English proficiency borrowers, while maintaining compliance with applicable law.

Ben Saul:

And two, for applicants who are recipients of income derived from part-time employment, alimony, child support, retirement benefits, and other forms of public assistance, whether servicers are evaluating that income in accordance with the technical requirements of ECOA and Regulation B when determining eligibility for loss mitigation options to the extent the servicer is otherwise required to use income in determining that eligibility.

Ben Saul:

Given this, I think if our clients haven't already examined their fair servicing policies, including how they back test outcomes to ensure compliance, now is for sure the time to do so.

Lisa Simonetti:

Ben, generally in that regard, what should clients focus on?

Ben Saul:

I think clients should be sure that they have a solid consistent omnichannel plan for borrower outreach, including to borrowers in majority/minority census tracks. They should be sure that they're comfortable with their Limited English Proficiency or LEP strategy, that they're documenting all the pre-foreclosure referral steps that they took in terms of outreach, that they're considering all loss mitigation options available to borrowers, and that they're doing so based on an objective set of criteria.

Ben Saul:

And finally, that they're testing, where appropriate, assistance and loss mitigation outcomes to see whether there are any problematic patterns that need to be addressed by corrective action, like amending policies and procedures or conducting certain employee training and so forth.

Lisa Simonetti:

Well, let's drill down into LEP for a couple of moments. You just mentioned that. In discussing fair servicing risks, you referenced earlier that regulators will be looking at this area and this issue cuts across all of consumer finance. How is the current CFPB thinking about LEP?

Ben Saul:

Like fair servicing, the challenges of serving LEP borrowers is not a new one for regulators to pay close attention to, but it's become a lot more significant to regulators, including the CFPB, because the new administration is prioritizing social justice and fair access to consumer financial products and services. The key Fair Lending concerns that have been articulated and that I think clients ought to be keeping at the top of mind is, one, under ECOA and FHA is LEP a proxy national or some other prohibited basis.

Ben Saul:

Under UDAAP, are LEP customers more vulnerable to deception or other UDAAP claims? Are lenders and servicers adhering to the technical requirements of ECOA, which allows you to make disclosures and languages other than English? But if so, to ensure that English language disclosures are available if somebody asks for them, or the technical requirements of TILA, which at least in the dwelling secured context, requires lenders to mix and match the language of key terms and disclosures.

Ben Saul:

And then another issue to keep top of mind is are lenders and servicers complying with state law, such as those in California and Texas that require you to provide disclosures in the language that was used in the loan negotiations themselves.

Lisa Simonetti:

That certainly is a risky landscape, Ben. What should our clients think about in terms of mitigation?

Ben Saul:

As a starting point, they can reference back to guidance concerning LEP practices that the bureau issued during the last administration, the tail end of the last administration in January 2021. That guidance offered the following compliance suggestions. First, consider creating and sending clear and timely disclosures to LEP speakers in languages other than English describing the limits of the language services that a lender or servicer provides in their products.

Ben Saul:

The LEP consumer in that instance should be placed on notice that certain language support might not be provided for a particular product at a particular point in the product's life cycle. And then secondly, the guidance provided that lenders should consider extending credit under legally compliant special purpose credit program. Beyond the CFPB's legacy guidance, we see across the industry, across our clients, some of the following best practices that I think are worth sharing with folks.

Ben Saul:

First, allowing customers to select their language and then tracking and documenting their selected language so that it applies to all the products that are offered to that customer, to expanding the translation of documents for consumers across the board. Three, closely monitoring the practices of third party vendors, including and maybe especially document translators, adding, for example, a layer of outside council review and approval as many of our clients already do.

Ben Saul:

And also, scrutinizing vendors who mail notices ensuring, for example, that those vendors are adhering to the lender's LEP standards and otherwise industry best practices. And then lastly, adhering just to basic compliance management system guidelines like documenting your decisions or auditing performance against policies and procedures and back testing outcomes. Those are all the things I think our clients can be doing now to mitigate LEP related risk.

Lisa Simonetti:

That's all good advice. At this point, let's shift to a cutting edge risk that you spotlighted at the outset, algorithmic bias. This has been an area of risk for some time, but thus far regulators have proven

hesitant to offer guidance or to pursue enforcement in this area because they needed time to understand the way in which predators and servicers use artificial intelligence machine learning. How are regulators thinking about this today?

Ben Saul:

While federal regulators, including the bureau, the FTC, DOJ, and the banking agencies would, I think, readily acknowledge that they have a lot still to learn about how artificial intelligence and machine learning can be used in the financial services space, including but not limited to credit underwriting, the current agency leadership clearly sees the risk of bias in algorithms as one that can't go unaddressed any longer.

Ben Saul:

While the banking agencies and the CFPB assimilate information that has been amassed in response to the 2021 interagency request for information on artificial intelligence and its myriad financial services related applications, and while we might see some guidance around bias mitigation best practices in the next year, the public language from the bureau and the FTC and the DOJ make it very clear that those agencies intend to bring enforcement actions in this space.

Ben Saul:

And while I won't rattle off a bunch of quotes, I would just say that those public statements are not being made just by the director Rohit Chopra at the CFPB. We have public statements in the last several weeks alone from the head of enforcement and of supervision policy expressing similar concerns and an intent on the part of the bureau to police this issue.

Lisa Simonetti:

What do you see as the key areas of enforcement risk for clients using algorithmic approaches?

Ben Saul:

At a high level, I think the CFPB and the FTC and the DOJ are going to focus on a number of different things. The first is digital redlining and digital reverse redlining. And here, there are a couple items that I want to just call out. The first, and this ties back to a risk area that those astute listeners will remember, there'll be a quiz afterwards, and which I highlighted was home appraisal bias.

Ben Saul:

The DOJ, the CFPB, and the GSCs have all expressed serious concern over the last several months that automated home valuation models might have bias baked into them, which results in lower valuations in majority minority areas, which in turn leads to mortgage denial disparities and digital redlining. In fact, just today, the CFPB signaled that it'll write a rule to govern automated valuation models by initiating a Small Business Advisory Review Panel or SBREFA process.

Ben Saul:

CFPB made clear in this announcement that it intends to craft the rule among other things to prohibit conflicts of interest, to limit the manipulation of data, and to preclude the use of proxies or other data inputs that the CFPB in its own words finds problematic.

Ben Saul:

Another area in which I think the agencies will focus on under digital redlining or reverse redlining theories is in the area of targeted marketing and solicitations, specifically whether those marketing communications have either exclusions in the modeling that cause them not to reach majority/minority census tracks or majority/minority categories of potential applicants, or because the delivery criteria in the artificial intelligence machine learning models that are used for this purpose learn and create criteria that have the result of screening out protected class borrowers.

Ben Saul:

Those are the two areas that I think will be spotlighted in that digital redlining, digital reverse redlining context by the agencies over the next several months, but there are a lot of other areas that are likely to get scrutiny in this algorithmic bias context. One of them is ECOA enforcement and disparate impact. We talked about disparate impact earlier and how it'll be used more aggressively.

Ben Saul:

I think algorithmic bias is the perfect case study for how to leverage that theory to bring causes of action, because the data inputs in artificial intelligence and machine learning models or the criteria that those models learn as they go are all facially neutral. Regulators are going to look for proxies in the data input towards this learned criteria that I mentioned that correlate to protected classes. Another area where I think algorithmic bias could pose risks to clients is the provision of adverse action notices.

Ben Saul:

Creditors who take an adverse action have obligations under the ECOA, as well as the Fair Credit Reporting Act to provide applicants with an explanation that's sufficient to explain why the creditor took an adverse action against them, like denying their application. Machine learning models present a real challenge in this regard because reducing the reason for an adverse action to something discernible to an applicant is challenging because the models are sometimes opaque, making it hard to know what the precise reason for a denial was.

Ben Saul:

And even when the denial reasons are discernible, sometimes presenting them in form of the data input category themselves can raise more questions on the part of a regulator than they resolve. Making this all more complicated is our clients have to manage delivering these notices often in conjunction with a vendor whose model is being used to make these decisions that result in an adverse action. Our clients have to grapple with who sends the notice, them or the vendor.

Ben Saul:

Another area where algorithmic bias is gathering regulatory attention is behavioral targeting. As we saw in the CFPB's ANPR on consumer data access, as well as the big tech payments market monitoring orders that the CFPB issued earlier this year, the CFPB's got a strong desire without regard to Fair Lending issues, per se, to police the use of data to target consumers for products that are higher cost or otherwise unsuitable.

Ben Saul:

In the Fair Lending context, as noted above, this could take the form of a reverse redlining case, but it's just as easy to see regulators advancing these concerns using their UDAAP powers. UDAAP claims for deceptive practices are likely to take other forms as well, including claims that clients may have over promised or hidden, what algorithms can do, what they can't do, and what they are doing. There are a number of risks for our clients to think about as they venture into this more tech enabled landscape.

Lisa Simonetti:

Again, what should our clients do to prepare, Ben?

Ben Saul:

Generally speaking, I'd suggest clients think about the following proactive steps to manage AI bias risks. First, they should remove protected class characteristics and proxies from data inputs in such models by having a layer of upfront and periodic qualitative Fair Lending review built into their Fair Lending compliance programs. I think they also should incorporate Fair Lending analysis into their model validation exercise, which historically has not been done.

Ben Saul:

What does that mean? For example, clients could have their internal data scientists work to identify under or overrepresented populations vis-a-vis their portfolio and market conditions. Clients can also conduct periodic Fair Lending statistical testing of outcomes and maybe think about pre-testing AI, ML models prior to putting them in production if test data sets are readily available. Clients should also establish business justifications. Recall our discussion of the disparate impact test.

Ben Saul:

When they do that, they should document the company's search for less discriminatory alternatives and conclude that none were found. They should also diligence and understand their vendor's use of AI and make sure that their compliance management system incorporates the vendor management protocol with this issue in mind. And lastly, they should consider the use of RegTech and new de-biasing techniques. There are amazing tools that are being deployed and the CFPB is aware of them.

Ben Saul:

One that I'd like to call to folks' attention is adversarial debiasing. What adversarial debiasing is or does is it takes two models, one, the model that makes the decision, and two, a model that tries to predict whether the decisions that the first model made are concerning borrowers of a certain race, gender, ethnicity, and so forth, and the models compete against each other until the first model, the model making the actual credit decision, can trick fully the second model, such that it can't tell what the race or gender and so forth is of the borrowers in the first model.

Ben Saul:

Hence, the first model is debiased. It strikes me that the brave new world in which our clients are operating will call upon them to leverage these types of tech, whether they're built proprietarily in house or procured through RegTech vendors, but I do think that this is a very important and frankly long-term cost effective consideration for our clients.

Lisa Simonetti:

Thank you, Ben. We've covered a lot of ground on this episode. Are there any final words that you'd like to leave with our listeners today?

Ben Saul:

Remember that failing to prepare is preparing to fail, although you can't know for sure what exactly the CFPB or other regulator is policing your fair landing practices are going to focus on in an exam or otherwise. And indeed, we've omitted a lot of more traditional areas of fair landing scrutiny from our discussion today, you can still bring a thoughtful risk-based approach to compliance assessments now to identify gaps in your Fair Lending programs that you can address now.

Ben Saul:

And for larger clients that are comprehensively examined, that may mean prioritizing either high risk areas for discreet assessments or areas that are flagged through dialogue with your examiner in charge as being ones that the agencies who regulate you are likely to focus on. In the end, it's important to be proactive in this environment with respect to understanding how your business clients are employing new technologies and how they're building tech enabled products, so that Fair Lending is baked into their consideration at the outset.

Lisa Simonetti:

This was a great conversation, Ben.

Ben Saul:

Lisa, thank you very much for having me. And of course, to the folks who are listening, thank you for your time and attention.

Lisa Simonetti:

Thanks everyone for joining us.