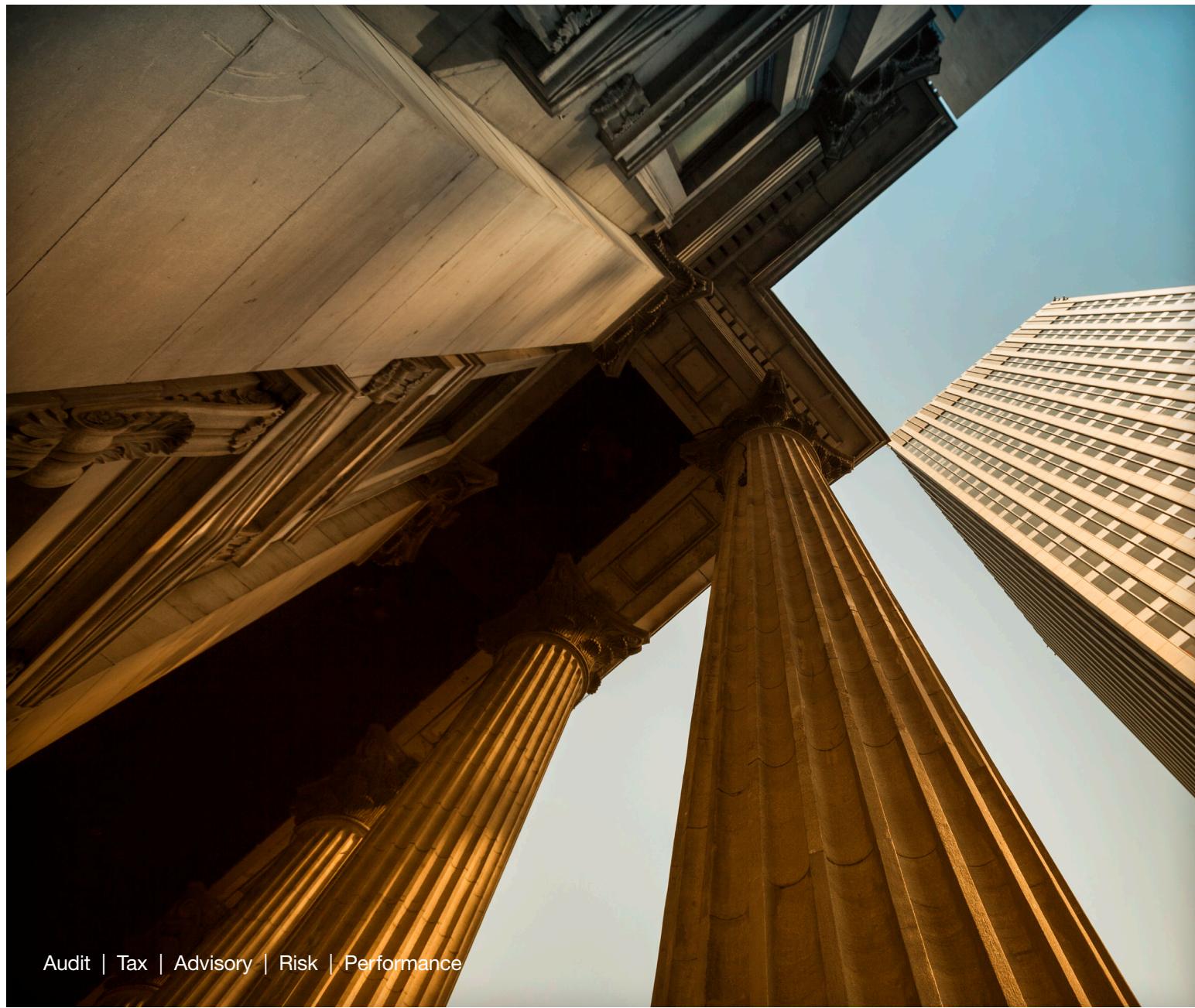


# Compliance Management: Making the Shift From Fair Lending to Fair and Responsible Banking

Taking a More Holistic View of Consumer Protection

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The emergence of the Consumer Financial Protection Bureau (CFPB) as a force in the financial services industry is creating waves, from enforcement actions to compliance management. Along with the U.S. Department of Justice (DOJ) and the various regulatory agencies, the CFPB is focusing more and more on a broader environment of consumer protection among banks and other financial services providers.

The CFPB is responsible for overseeing many consumer protection laws, including the *Equal Credit Opportunity Act* (ECOA), the *Home Mortgage Disclosure Act* (HMDA) and the *Truth in Lending Act* (TILA). It also serves as the entity primarily responsible for enforcement of consumer financial laws for depository institutions with more than \$10 billion in assets. Banks are finding that the involvement of the CFPB is translating into greater scrutiny of not just traditional brick-and-mortar institutions but also more specialized areas, including debt collection and student lending. Recent rule changes to HMDA data collection and reporting are likely to further extend CFPB's enforcement efforts.

In response, banks must make the shift from managing discrete aspects of compliance, such as discrimination and community reinvestment, to taking a more holistic and comprehensive view of consumer protection.

## The Wide World of “Fair and Responsible Banking”

When the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) created the CFPB in 2010, five objectives and six functions were explicitly defined as its primary areas of responsibility. The CFPB was to see that “consumers are protected from unfair, deceptive or abusive acts and practices and from discrimination,” and one of its responsibilities related to “collecting, investigating, and responding to consumer complaints.” Although the CFPB’s mandate extends to other areas – such as its efforts to increase market transparency and its role in the enforcement of consumer financial laws – the bureau’s actions are often activated by its objective of protecting consumers from possible harm and using its Office of Consumer Response to identify action that might require further investigation or enforcement.

The manifestations of consumer harm that fall under the CFPB’s purview encompass a wider variety of bank-customer interactions than previously defined. The bureau considers the full array of a bank’s interactions with a consumer that could result in abuse or other harm, beginning with marketing and continuing through the application, servicing, and debt collection processes. Effective compliance management requires a global perspective that includes but looks beyond fair lending. The failure to consider the overall consumer relationship can prove costly.

The focus on consumer protection and close scrutiny of banks’ practices has brought greater attention to overdraft and activity fees, too. In April 2015, the CFPB announced its first enforcement action under the 2010 rules prohibiting banks and credit unions from charging overdraft fees on ATM and one-time debit card transactions unless consumers opted in.<sup>1</sup> According to the bureau, Alabama-based Regions Bank failed to ask consumers if they wanted overdraft service before charging them fees. In the end, hundreds of thousands of consumers paid at least \$49 million in illegal charges. The CFPB required the bank to fully refund the affected consumers and fined it \$7.5 million for its illegal actions and slow response to correct the errors. The bureau also has issued consumer advisories on how to avoid overdraft fees.

Of course, fair lending is a critical component of fair and responsible banking. With the emphasis on consumer harm, however, regulators are looking at a wide spectrum of lending practices rather than maintaining a narrow focus on mortgage loans. For example, the CFPB is also investigating disparate practices by automotive lenders, consumer lenders, and credit card providers.

## The Driving Role of Consumer Complaint Data

One of the CFPB's major initiatives is collecting consumer complaint data that it must investigate and potentially adjudicate with banks. This data has been a primary driver of enforcement actions and should also be valuable to banks' understanding of their potential risk factors. Systems and processes designed solely for mitigating risks related to the risk factors enumerated in the regulators' examination procedures may require adjustments to account for the myriad ways that "consumer harm" can manifest today.

Moreover, banks must realize that many "fair and responsible banking" violations will relate to incidents that previously would have been identified only in the examination process, meaning they could go undiscovered for a year or longer. With consumer complaints now triggering action, investigations and penalties are likely to occur at a greater frequency.

In addition, the CFPB is making the consumer complaint data publicly available, on virtually a real-time basis. In addition to its [Consumer Complaint Database](#), the bureau publishes a [Monthly Complaint Report](#). The report includes complaint volume by product, state, and company, with a spotlight on a particular product (for example, payday loans, mortgages, credit cards, student loans, prepaid card products, or money transfer services) and a particular geographic area (for example, the New York metro area). Banks must account for the possible risk factors associated with consumer complaints, such as the potential involvement of advocacy groups in response to complaint data.

*The BISG method assesses the probability that a consumer belongs to a particular racial or ethnic group by analyzing his or her location and surname.*

## Consumer Lending Enforcement and BISG

Regulators have run into some challenges during their attempts to identify disparate treatment of different classes of applicants. Although ECOA and HMDA require lenders to collect Government Monitoring Information (GMI) on mortgage applicants' gender, race, and ethnicity, similar information collection cannot be collected for other forms of consumer finance such as automobile lending and credit card origination.

The CFPB has turned to proxy analysis, primarily the [Bayesian Improved Surname Geocoding](#) (BISG) method, to determine the race and ethnicity of a consumer when lenders aren't allowed to collect the consumer's demographic information directly. The model assesses the probability that a consumer belongs to a particular racial or ethnic group by analyzing the consumer's location and surname.

Banks attempting to apply BISG can expect to encounter several common hurdles. For example, it's extremely resource-intensive and costly to perform geocoding and implement the necessary algorithms to generate probabilities for each loan in a bank's portfolio. Small and mid-size banks in particular may lack the necessary technical and computational resources to employ BISG. In addition, the data of the many banks that have never used the method before might not be in the appropriate form. Not surprisingly, the use of the BISG proxy method has been the subject of vocal and ongoing challenges from both the industry and the U.S. Congress.

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<sup>1</sup> CFPB, "CFPB Fines Regions Bank \$7.5 Million for Unlawful Overdraft Practices: Bank Refunds \$49 Million in Illegal Fees to Consumers Who Did Not Opt-In to Overdraft," April 28, 2015, <http://www.consumerfinance.gov/newsroom/cfpb-fines-regions-bank-7-5-million-for-unlawful-overdraft-practices/>

## Expanded HMDA Data Collection and Reporting

To complicate matters even more, banks will soon need to collect significantly more HMDA data. In October 2015, the CFPB [published its final rule expanding the reporting requirements](#), as called for in Dodd-Frank. Beginning in 2018, the number of fields to be filled in will jump from 24 to 48, with banks expected to collect more information on applicant credit characteristics – including credit score, debt-to-income ratio, and combined loan-to-value – as well as information about outcomes from the bank's underwriting systems. In addition, reporting on home equity line of credit (HELOC) activity will no longer be voluntary; HELOCs will be categorized with closed mortgages for reporting purposes, making reporting mandatory.

The doubling of fields has obvious implications for banks' collection process burden. But the implications for enforcement are even more dramatic. Armed with a deeper understanding of the credit quality of individual applicants, examiners will be able to perform a more robust quantitative analysis on an annual basis. The expanded data could make it easier for them to identify possible violations of the ECOA and will provide the CFPB with more ammunition to pursue enforcement actions.

## Preparing for Fair Banking Compliance Management

Banks should take steps now to understand their risks related to fair and responsible banking, paying attention to areas like the integrity of their data systems and whether practices could disadvantage certain groups or otherwise harm consumers. It's vital that banks prepare for examination of these and other areas that haven't been examined before, either by regulators or the banks themselves. Banks that also stay abreast of enforcement actions and industry trends will find that the transition from examination-driven to complaint-driven enforcement may require a more complex approach to risk management.

The expanded HMDA data collection rules don't take effect until 2018, but the CFPB and regulators have already expanded their focus. To manage fair and responsible banking risk factors, the compliance function must understand – and collaborate with – areas of the bank that haven't been subject to compliance before. Mitigation that meets and exceeds regulatory requirements will require a proactive and cross-functional road map.