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A COLLECTION OF COMMENTARIES ON THE CRITICAL LEGAL ISSUES IN THE YEAR AHEAD

Consumer Financial Protection Bureau Focuses on Fair Lending

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Having enacted a number of mortgage-related rules on the eve of statutory deadlines, the Consumer Financial Protection Bureau (CFPB), which now has a confirmed director, has shifted its focus to fair lending enforcement, announcing two major actions in December 2013. In 2014, we expect the CFPB to rely heavily on the disparate impact theory and continue its fair lending enforcement in a manner that may have transformative effects for auto and mortgage lending.

Since its inception with the passage of the Dodd-Frank Act, the CFPB's authority had been limited because the act required a permanent director for the bureau to exercise many of its authorities. After a court decision had called into question President Obama's recess appointment of Richard Cordray as the bureau's director, the Senate confirmed Cordray's appointment as director in August 2013. And despite a pending lawsuit challenging the CFPB's constitutionality, the bureau now is vested with authority to exercise all of the broad powers granted to it by Dodd-Frank.

Auto Lending

The bureau has closely scrutinized dealer "markup" — a common industry practice whereby dealers are compensated based on the difference between the auto finance company's "buy rate" and the interest rate negotiated between the dealer and the consumer. In March 2013, the CFPB released a bulletin stating that markup creates a risk of pricing disparities on the basis of race, national origin and potentially other prohibited bases. The bureau advised lenders to mitigate these risks by implementing a robust fair lending compliance management system that includes statistical monitoring to determine whether dealer markup compensation is higher on finance contracts with, for example, minority consumers as compared to nonminority consumers, and to provide remediation to adversely affected consumers. Alternatively, the bureau stated that dealers could mitigate fair lending risk by eliminating dealer markup compensation.

On December 20, 2013, the bureau announced a consent order with Ally Financial Inc. and Ally Bank (Ally) settling allegations that Ally's dealer compensation policies resulted in higher dealer markup on loans to African-American, Hispanic and Asian/Pacific Islander consumers. Under the terms of the settlement, Ally agreed to pay $80 million to consumers and an $18 million civil penalty. Additionally, Ally agreed to conduct ongoing monitoring of dealer markup disparities and provide payments to affected consumers based on the results of those analyses throughout the term of the agreement or until Ally adopts a nondiscretionary dealer compensation plan. The Ally enforcement action, which is the CFPB's first major fair lending enforcement action, was coordinated with the U.S. Department of Justice (DOJ).

A number of unresolved issues remain, many of which were discussed in a CFPB indirect auto lending public forum in November 2013. One open issue is how to conduct statistical analyses to determine whether minorities and other protected class consumers have paid more than similarly situated nonprotected class consumers, given that lenders are prohibited under federal law from collecting information on the consumer's race, ethnicity and sex. While there are a number of different "proxy" methodologies

using names and geography to estimate the race, ethnicity or sex of the consumer, there is no single prescribed approach. In addition, some commentators have questioned whether monitoring programs are feasible or effective. Other issues include whether dealer markup policies have a positive or negative impact on consumers, as well as potential alternative dealer compensation structures such as paying dealers a flat fee or fixed percentage on each finance contract.

Mortgage Lending

We also expect that the CFPB will continue fair lending scrutiny of mortgage lending. On December 23, 2013, the CFPB announced its first mortgage fair lending enforcement action, with National City Bank. Under the terms of a consent order, National City Bank agreed to pay $35 million to consumers to settle allegations that it charged higher prices to African-American and Hispanic consumers on mortgage loans as compared to similarly situated non-Hispanic white borrowers. The consent order, which the CFPB filed jointly with the DOJ, alleged that higher pricing to minorities resulted from discretionary pricing practices in the bank's retail channel and through mortgage brokers.

> "The CFPB has indicated that redlining and underwriting issues will be its top mortgage fair lending priorities."

Although the National City Bank enforcement action and other recent DOJ mortgage cases have addressed pricing, the CFPB has indicated that redlining and underwriting issues will be its top mortgage fair lending priorities, with continued attention on pricing and steering as well. Also, beginning in January 2014, mortgage lenders will be required to comply with a new ability-to-repay rule, loan officer compensation rules and other requirements. In response to significant industry concerns, the CFPB and other federal regulators issued guidance in October 2013 regarding fair lending implications of the new ability-to-repay and qualified mortgage rules. Consistent with the CFPB's guidance, lenders who are considering curtailing lending that falls outside of the qualified mortgage criteria in response to the new ability-to-repay rule should consider the potential fair lending implications of these changes. Finally, in 2014, we anticipate that the CFPB will propose and possibly finalize rules for enhanced reporting and disclosure requirements for mortgage and small business lending, which likely will lead to increased CFPB scrutiny. In anticipation of enhanced regulatory scrutiny in these areas, mortgage and small business lenders may wish to analyze their mortgage and small business pricing, underwriting, and compliance policies and procedures.