



Financial Services Management

Anti-Discrimination Enforcement

Cite

CFPB, Examination Manual, Unfair, Deceptive, or Abusive Acts or Practices

Recommended Distribution:

Risk Management, Policy, Compliance, Audit/Examination,
Legal, Government Relations

Website:

https://files.consumerfinance.gov/f/documents/cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf

Impact Assessment

- Compliance, legal, and reputational risk across the full spectrum of consumer-financial and related services is sharply increased.
- Acts and practices deemed permissible under applicable federal and state law may be sanctioned if CFPB examiners think this warranted.
- The absence of regulatory criteria for enforcement intervention may lead to inconsistent supervision and even regulatory arbitrage.
- Third-party vendors and companies working with regulated consumer-finance providers may face enforcement actions even if otherwise outside the CFPB's purview.
- AI and other innovation may slow, but a new focus on fairness may enhance sustained implementation.

Overview

Reflecting one of its new director's top priorities as well as that of the Biden Administration, the Bureau of Consumer Financial Protection has significantly revised its examination manual when it comes to behavior that might be viewed as discriminatory in a wide range of consumer-financial products, services, underwriting, advertising, marketing, governance, and other arenas. Because the new approach is both sweeping and imprecise, different examiners and/or different CFPB offices may reach different interpretations of data and company attributes as indications of discrimination. The Bureau has thus put the entire sector on notice that anything that might have even the appearance of overt discrimination, discriminatory treatment, or disparate impact could result in CFPB sanction. The new manual also stipulates that examiners should intervene even

if behavior they believe to be discriminatory does not expressly come under the laws (e.g., the Equal Credit Opportunity Act) clearly within the Bureau's jurisdiction if examiners believe an act or practice by a regulated company or those with whom it works is discriminatory and therefore unfair, deceptive, and/or abusive. This may lead to enforcement actions that, in the absence of information available to bank examiners regarding safety and soundness, may lead to both conflicts with the banking agencies and risk to retail banks across the country. Given the impact of even the beginning of an enforcement action in this arena, consumer-finance companies may now need to quickly review and in some cases create internal controls, model-validation methodologies, governance standards, and other policies and procedures even if they serve only as third-party vendors or counterparties to a company directly under the CFPB's authority.

Impact

The Bureau's action takes the form of significant revisions to the 2012 exam manual that has long guided the agency in the area of unfair, deceptive or abusive acts and practices (UDAAPs). The penalties for UDAAP are significant not only for targeted entities, but also for any third parties deemed to have knowingly assisted the sanctioned act or practice.¹ As a result, the CFPB's new approach poses significant compliance, legal, and reputational risk not only to the financial companies it directly governs, but possibly also to real-estate brokers, credit insurers, auto dealers, and others outside the express reach of the agency's jurisdiction.

Because these policy changes are embodied in only this exam manual, consumer-finance companies and others know in general terms what supervisors now will review and request, but not the specific criteria that will guide judgments about when they are at risk of enforcement actions. There are no clear parameters for supervisory discretion; indeed, the manual expressly says that legal compliance does not ensure protection from enforcement action.

The agency's examiners may thus determine that, even if an act or practice is "technically" legal, it is nonetheless unfair, deceptive, or abusive, perhaps doing so without full knowledge of the safety-and-soundness rules that govern a banking organization, market conditions, GSE or other underwriting or loan-purchase requirements, or risk-tolerance considerations that may correlate with demographic groupings but not be caused by them. Instances of disparate impact, where policies have discriminatory effect without necessarily being the result of intentional discrimination, have long been challenging to identify even within the boundaries of applicable law and rule.² Doing so without legal criteria may be particularly challenging for both supervisors and those they examine.

Because of the reach of the Bureau's UDAAP authority, entities that have believed themselves immune from CFPB jurisdiction or are even statutorily exempt from it could find themselves subject to enforcement action. These entities could include mortgage and title insurers, realtors, and AI/ML vendors or others setting underwriting, pricing, or other market factors penalized by

¹ See **CONSUMER14**, *Financial Services Management*, July 19, 2010.

² See **FAIRLEND7**, *Financial Services Management*, July 31, 2020.

examiners at companies making use of their services or working with them to complete transactions. The Bureau is also reviewing an array of financial-services activities at bigtech companies. Even if none of these is illegal or otherwise outside the CFPB's reach, the UDAAP framework established in this manual could also extend to some of the largest tech-platform companies and/or the financial firms providing them with payment or other infrastructure services. Secondary-market issuers setting underwriting terms aimed at attracting investors to mortgage, credit-card, or other financial credit products could also be sanctioned if the Bureau believes these standards are discriminatory.

Banks are clearly among the Bureau's immediate targets, with the manual and related documents emphasizing the agency's plans to assess the extent to which banks provide African Americans with deposit accounts on fair terms and conditions. Director Chopra has focused on deposit-pricing as an area of particular concern,³ with this manual now giving the agency reach into the deposit-tracking systems many banks use to access fraud risk as well as the extent to which small-balance accounts may receive returns the Bureau thinks discriminatory when compared to larger balances most likely to belong to white or Asian households. The Bureau's ongoing investigation of "junk fees" would also gain significant enforcement clout if the agency thinks these fees are abusive not only due to race or other protected bases, but also for any of the other reasons cited in the request for comment.⁴

What's Next

This manual was released on March 16 and now guides CFPB examinations and subsequent decision-making. Although its changes are significant, these were not proposed for public comment, just incorporated in the 2012 exam manual. It is possible that this process might be considered undue under the Administrative Procedures Act, perhaps giving enforcement-action targets a defense to the extent an alleged violation does not clearly fall under applicable prior regulation or law.

Analysis

The CFPB's new policy takes the form of new text scattered throughout the current exam manual. Key changes include:

- There is now express application of anti-discrimination considerations in the array of sections that may be examined for UDAAP and punished accordingly.
- Consumer harm is defined not just to include costs, but also "forgone monetary benefits" or the denial of access to products and services resulting from discrimination.

³ See **CONSUMER37**, *Financial Services Management*, October 27, 2021.

⁴ See **CONSUMER38**, *Financial Services Management*, February 1, 2022.

- UDAAP may occur even if federal fair-lending law does not apply, for example if Blacks are denied deposit accounts or subjected to different criteria to obtain them.
- Examiners are to review documentation related to algorithms, models, and decision-making related to consumer products and services, with the manual not specifying if this is to be limited only to discrimination but also cover the full range of federal law, rule, and possible UDAAP as seems to be intended.
- Examiners are to review firm governance to ensure that a process exists to prevent discrimination in all aspects of consumer finance offerings that are then monitored for any subsequent discriminatory effect. This anti-discrimination assessment is to include all decision-making processes.
- Internal controls are also to be reviewed for discrimination analysis, assessment, and mitigation as well as the extent to which all offerings may exclude or adversely treat some demographic groups.
- Examiners are also to test transactions to prevent discrimination in direct or indirect ways, including via service access and pricing, customer-service treatment (with an eye especially on consumers with limited English proficiency), underwriting, servicing, collection, and other practices.