



GSE Activity Report

Wednesday, June 1, 2022

How Adverse Is This?

Summary

As detailed in our [new in-depth report](#), the CFPB has issued another sweeping rule by way of a seemingly innocuous circular not subject to public notice and comment. [Under it](#), lenders that use third-party underwriting are responsible for ensuring that borrowers receive thorough adverse action notices even if the lender has no authority over the AI or other complex models determining credit outcome.

Impact

Most GSE and FHA originators have long provided adverse action notices when mortgage apps are rejected, leading some to shrug off the CFPB's latest pronouncement. However, our read of the details makes it clear that this view is unduly sanguine, especially if it is held by fintech or nonbank originators who think by virtue of their size or business model that they are exempt from the CFPB's jurisdiction.

For why they aren't, see our analyses of the CFPB's new UDAAP examination manual and its declaration of enforcement authority even over nonbanks not expressly subject to its [supervision](#). Further, this circular bites even if lenders acknowledge the CFPB's jurisdiction but think they're still immune because they only make the loans approved under third-party underwriting systems such as those imposed by the GSEs or correspondent banks.

Currently, lenders generally defer – as indeed they must – to GSE AU/LP decisions, but the CFPB believes that adverse action notices in this case all too often provide only what the Bureau calls “ad hoc” mention of denial reasons, such as failure to meet a desired credit score. Under the new standards, the reason cited in the adverse action notice must be precise and accurate, not just sort of fitting into one of the boxes checked using the sample notice form. It's possible that the near-term headaches of this new requirement might be offset over time by more transparency that lenders have long sought from the GSEs, but this remains to be seen.

The sweep of the Bureau's new policy is even broader when taking into account one other critical edict: an [advisory](#) indicating that adverse action notices are required not only for credit applications, but also for decisions adverse to the borrower on outstanding obligations (e.g., alteration of a line of credit). Here, GSE AU/LP systems are not the issue, just those the lender itself deploys to add products to the basic mortgage. To the extent these products are underwritten using third-party models or done in concert with a correspondent lender, fintech, or other entity, the lender still must know the reason for denial or adverse action and send a clear, compliant notice to this effect.

Outlook

The Bureau issued this edict on May 26. It's effective immediately and the Bureau provides no

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

© 2022 Federal Financial Analytics. All Rights Reserved.

indication that its examiners will be merciful to lenders that struggle to pierce AI opacity as they develop good-faith compliance efforts that will take time to institute. Knowing the CFPB, we expect it to make rapid use of this new policy to pick on a lender – most likely a nonbank – to make an example off in order to chasten other providers as quickly as possible.