
THE CONSUMER FINANCE PODCAST: TROUTMAN PEPPER ATTORNEYS UPDATE FAIR LENDING HANDBOOK FOR THE AMERICAN ASSOCIATION OF BANK DIRECTORS

HOST: CHRIS WILLIS

GUESTS: LORI SOMMERFIELD AND DAVID BARIS

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Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services regulatory practice, and I'm really glad you've joined us today so that I can introduce you to a special joint project that we've just done with the American Association of Bank Directors in that we published a book together. But before we get into that announcement, let me remind you to visit and subscribe to our two blogs. We have [consumerfinancialserviceslawmonitor.com](https://www.consumerfinancialserviceslawmonitor.com) that covers everything that goes on in the world of consumer finance. And we have [troutmanpepperfinancialservices.com](https://www.troutmanpepperfinancialservices.com), which covers the wider world of everything that affects financial services companies. So visit both of those and subscribe to them today. And of course, don't forget about our other podcasts. We have a bumper crop of them. We have the [FCRA Focus](#), all about credit reporting, [The Crypto Exchange](#) about everything Crypto. We have [Unauthorized Access](#), which is our privacy and data security podcast and our newest podcast, [Payments Pros](#), is all about the payments industry. So subscribe to any of those on any of the popular podcast platforms because you'll find them all there. And speaking of those platforms, if you like this podcast, let us know. Leave us a review on your podcast platform of choice and let us know how we're doing.

Now, as I said, today we're going to be talking about a special announcement because some members of our group, myself included, have co-authored a book with the American Association of Bank Directors, and joining me to talk about that today are two very special guests. First, I have my partner, Lori Sommerfield, who you hear on this podcast all the time, who's a specialist in fair lending, which is going to be apropos to the topic we're discussing today. But our very special guest is David Baris. He's the president of the American Association of Bank Directors. He's led that association since its founding in 1989, to provide bank directors with resources where they can serve their institutions effectively and in a manner that minimizes both the risk of personal liability, but stays consistent with safe and sound banking practices. And the AABD supports bank directors and officers through its advocacy information and training initiatives. David was also a banking law partner in private practice as well as serving on Council on the Hill dealing with banking issues, and he's the author of seven books and numerous articles on bank director issues. David, Lori, thanks a lot for joining me on the podcast today.

David Baris:

Thank you very much, Chris for inviting me. It's been a pleasure to work with you and Lori on the second edition.

Lori Sommerfield:

And Chris, it's great to be here as always, and it's been such a pleasure to work with you too, David, on the second edition of the book.

Chris Willis:

The book that we're talking about is called *Practical Handbook on Fair Lending for Bank Directors and Executive Officers*. It's the second edition, as Lori just mentioned, and David, Lori, I and one of our colleagues, Sarah Pruet, are the authors on the book. And it's just been released. It's actually available on Amazon, and my parents are very impressed. I now have a book published on Amazon, that really, really impressed them, and I'm sure that worked for you too as well, Lori. But let me get into what this

book is about. David, I understand it was your vision to create the first edition of this Fair Lending Handbook back in 2015, and the book was then first published in 2016. Can you tell the audience about your thinking in terms of what you wanted to achieve when you created this handbook for AABD members and what's the book supposed to do?

David Baris:

The first edition, I was with a law firm and Lori was also there and was very instrumental in helping to create the first edition. What we learned very early on in 1989 and even before that was that bank directors need good information in order to conduct their business, which is supervising their institution and management, but they need to know enough to ask intelligent questions. And so the objective of the book was to delve into a subject that was becoming more and more important to the banking industry in a way that would make it useful for the bank directors. So, we started off with the idea of a 20-page book that would be devoted solely to the bank directors, and we ended up with a much longer book because we also realized that there were others in the bank who needed more information as well, not just the bank directors.

We've segregated the book in a way where the bank directors can go in and read 20 pages that we selected and be sufficiently informed so they can ask intelligent questions of the management team. At the same time, it's a resource for others within the institution and also outside. Why was it the fair lending? Well, that was becoming more and more of an issue at the time in 2015, and it's increasingly an issue and one that the directors called me about, many of them, and said, "We don't know much about this, but we're getting hit with an enforcement action. We don't know what happened," and they didn't have a clue.

So, we wanted a book to be able to focus on that subject discreetly and help these directors get through their problems or to avoid the problems in the first place. So that was the first edition. The second edition was a realization that there was a lot that has changed, and so we wanted the directors to know what those changes are and what they may become. We want them to be on the cutting edge. We want them to be anticipatory. We want them to be as prepared as they can be for that next bank examination, either from the banking agencies or from CFPD or both.

Chris Willis:

Got it. And one of the things that I was really struck by when I read the first edition and when I assisted you and Lori in putting together the second edition is the first word and the title is practical. It's a practical handbook on fair lending for bank directors and executives, and it really does have a very practical focus that's geared towards staying away from a lot of esoteric legal stuff and really focusing on the practical things that bank managers need to know. Was that part of your vision as well?

David Baris:

Oh, yes, yes, very much so. The directors are bombarded by regulation and information requirements, and we figure that the average board package is now easily over 600 pages a month and going up and with the Silicon Valley Bank failure and the others, there's accusations out there that the directors don't know enough or don't have enough information, so it can expect from 6 or 700 pages to go up even higher. So, we want to simplify things. If we could write the 20-page book, we would've done it and we could do it, except that we also want to include others who need to know more as well.

Chris Willis:

Got it. And as we mentioned, the original version of this book, which you had created, came out in 2016, what was the impetus for wanting to release a second edition, which just came out in June of this year?

David Baris:

Well, the second was the realization that more is happening. We were getting questions, calls from bankers and bank directors asking about an update, and so we were responding in part to our audience. And so we have great gratitude to Lori and you all to help us reach the second edition because an update was very important, and I think we have it here.

Chris Willis:

You talked about serving your audience, and we mentioned bank directors of course, but are there other constituencies within a bank that you think would benefit from having access to this book?

David Baris:

Absolutely. Your fair lending officer, your chief compliance officer, your committee that's responsible at the board level, all these people. The CEO needs to know at least as much as the board needs to know. The CEO doesn't necessarily need to know everything that the chief compliance officer knows. So, CEO is in a position similar to that of an outside director as to fair lending. We wanted this book to be meaningful to all the constituencies that are within the institution.

Chris Willis:

Lori, let me switch over to you now. Over the seven years since the book was first published in 2016, we've seen a lot of fair lending, legal and regulatory developments under both the intervening administrations that the book really serves to update readers on. And of course, you're at the center of this because this is an area that you work in all the time. Can you give our listeners an idea of what some of the more significant developments were that are highlighted in the book?

Lori Sommerfield:

Sure, Chris, it's hard to pick and choose because there are so many developments that have occurred over the last seven years, but I think I'll focus on four. Top of mind for me is probably the inter-agency effort to combat redlining practices that was announced back in October of 2021 by the DOJ together with the CFPB and the OCC. Although the federal banking agencies have undertaken redlining enforcement actions since the early 1990s, we really haven't seen an all-government approach to enforcement before. So it's truly unprecedented in terms of scope and scale. And as a result of that initiative, we've seen several public redlining enforcement actions announced since that time. And as a result of our contacts within the Department of Justice, we know there are many more in the pipeline. Another significant development in my view is that HUD finally issued its disparate impact final rule this spring after many, many attempts to promulgate that rule since 2013.

It's been a really long saga. But let me just give a brief version of what happened for the audience. And by the way, we did a podcast on this topic so if you're interested in finding out more detail about HUD's disparate impact rule, you can check that out. Basically what happened is that HUD issued its first disparate impact rule back in 2013. Following onto that, the US Supreme Court issued a decision in inclusive communities in 2015 that caused HUD to realign the three-step burden shifting test that was in its 2013 rule with that Supreme Court case. So HUD then issued another final rule in 2020. That rule was stayed as a result of litigation. Then President Biden took office in 2021 and he basically ordered HUD to revisit the 2020 version of the rule. And after seeking comments, HUD just finally issued the third final rule this past spring. So now we're back to the original version of the 2013 disparate impact rule, and hopefully this is a truly final version, or at least until the next administration takes office.

Chris Willis:

Sure, it's just going to be a political football, but we have the final for now version, is what I'd like to call it.

Lori Sommerfield:

That's exactly right. That's exactly right, Chris. I'd also place on the list of significant developments, the new focus of the CFPB and other federal regulators on algorithmic bias and potential discrimination in the use of automated systems for purposes like credit decisioning and marketing. And Chris, you're very familiar with this topic because you and I spend a lot of time on this issue. Interestingly, while under the Trump administration, the CFPB expressed a favorable view that artificial intelligence and machine learning models offer the potential for expanding access to credit. The same bureau is now stating that these technological advances can actually increase fair lending risk by replicating and amplifying bias. So the CFPB is now clearly suspicious about these black box models. One thing the audience should be aware of is that very recently in April of 2023, several federal government agencies issued an inter-agency statement on the agency's efforts to engage in enforcement against discrimination and bias in automated systems.

And that to me seems to be the first attempt to regulate the use of artificial intelligence and the CFPB, the DOJ, the federal banking agencies, all contributed to this inter-agency statement. So, it now seems to be becoming a full court press on bias and discrimination that can be found in automated systems and AI innovation. So stay tuned for more information and developments on that score. And finally, I'd like to mention another development, and this isn't exactly fair lending oriented, it's really more responsible banking, but the CFPB made a dramatic expansion of its UDAAP authority back in March of 2022. This is very significant to the banking industry. Last year, the Bureau declared that discrimination is now actionable under the unfairness prong of UDAAP, and they did this simply by issuing a press release and an amended UDAAP exam manual.

The Bureau stated that its authority now extends to any financial product or service, not just credit products, and it will examine for discrimination and all consumer financial markets including the servicing, collections, consumer reporting, payments, deposits, and remittances. Specifically, the CFPB is going to ask its examiners to require supervised companies to show their processes for the way that they assess risks and discriminatory outcomes. So that includes documentation of customer demographics as well as the impact of products and services and fees on different demographic groups. Examiners are also going to look at how companies test and monitor their decision-making processes for unfair discrimination as well as looking at potential discrimination under the Equal Credit Opportunity Act. This is really a major sea change. The good news is we're not really actually seeing the CFPB examine in a substantive way for this expansive interpretation of UDAAP. They're really just looking at requesting and reviewing policies and procedures at this point, but this is a development that we'll all want to keep an eye on.

Chris Willis:

That's a lot that's happened since the first edition of the book was published in 2016. And of course, as you said, the book goes through and describes what both bank directors, executives, compliance professionals, et cetera, need to know to sort of adapt to these new features of the fair lending landscape. But let's talk about some other stuff that I know you also highlighted in the book. What trends are we seeing now in fair Lending supervision and enforcement that we've tipped the readers of the book off to in which you're now going to tip our listeners off to as well?

Lori Sommerfield:

Well, I think redlining practices are clearly a focal point in both examinations and enforcement for the CFPB and the federal banking agencies as part of this inter-agency effort that I mentioned. And we're especially seeing a focus on "Reasonably Expected Market Area" or REMA, in exams. And for those of you that are familiar with this concept, it's really an examiner's determination of where an institution actually marketed and provided credit versus where it could reasonably expect it to have done so. There's really no good guidance that exists on the REMA concept. It's just set forth in the exam manual and examiners carry out. It's difficult to refute those allegations when they do arise because it comes down to basically a battle of wills in the data and the opinions of the institution versus the examiners about whether there's a problem with an institution's REMA.

We're also seeing referrals to the Department of Justice from the CFPB and the federal banking agencies for alleged pattern or practices of discrimination under ECOA and the Fair Housing Act. Matters include not only redlining, but also indirect auto lending pricing and underwriting discrimination in student lending, among others. These referrals to DOJ go on all the time, but I think we're seeing an uptick in them, we certainly do under democratic administrations. And then finally, I guess I'll mention fair lending risk from third party activity is also a trend that we're seeing in fair lending, supervision and enforcement. That's, for example, a situation where a financial institution relies on a third party to underwrite or price credit, and ultimately the institution is responsible for managing those fair lending risks. The audience has probably seen the consent order that the FDIC entered into with Cross River Bank, that's an example of third party risk. It wasn't strictly focused on fair lending, it was broader than that, but we're seeing a lot of focus in that area, particularly with online platforms where you have these bank and FinTech partnerships.

Chris Willis:

Thanks a lot, Lori. Just one final question for you that I know you also talk about in the book, which is, how are fair lending issues currently playing out in examinations and in banks' relationships with their exam teams?

Lori Sommerfield:

We typically see field examination staff curing out fair lending exams with appropriate focal points based on the data and the information they have about institutions, and they frequently demonstrate an understanding of banks' fair lending compliance challenges and try to work with them. But when a fair lending issue gets escalated to a regional office or Washington, then we see the dynamics change. We especially see the influence of the Washington headquarters staff when a significant issue like alleged redlining or a pattern or practice of discrimination is escalated and then the agenda is clearly driven by DC and the examiners have much less influence over the outcome. This scenario is probably more prevalent in community banking, but we also see it play out with regional banks and even large banks. David, would you care to comment on that from the perspective of your constituency in AABD?

David Baris:

The examination function is at the heart in many cases of where the fair lending issue arises, and it's extremely important for the management team, and to some extent even the board members, to be engaged in that process because if it is a bad examination that goes to the regional office, as you say, a national, and then it has a life of its own and it's often hard to stop the train at that point.

I think it's also important for the board to be visible to the examiners to show them they're engaged at meetings. There may even be use for the chairperson or some other director to be present at one or more meetings with the examiners during the examination itself. There's also the preparation for the exam, the conduct during the exam, and then what happens after the exam but before the report of examination is issued. That piece is something that a lot of boards don't fully appreciate, that they can be involved, to some extent. Management is mainly involved, but to some extent the board's going to be overseeing that process and that examination level can dictate a lot of what may happen later.

Chris Willis:

That makes sense, David, and just one last question to you. If our listeners are interested in getting a copy of the book, where would they go to find it?

David Baris:

Amazon's agreed to publish it, and so Amazon is a great resource and we would encourage the listeners to go to Amazon's website and purchase the book. Certainly our phones are open, and if anyone has any questions about the book, they may give us a call. And I'm sure Lori and you, Chris, would be willing to accept a call relating to that book.

Chris Willis:

Yeah, of course. And just again, for the listener's reference, it's called *Practical Handbook on Fair Lending for Bank Directors and Executive Officers* (2nd ed.). David Baris, Lori Sommerfield, myself, and Sarah Pruett are the four listed authors and you can just search for it on Amazon and it comes right on up. So I'm going to have to show off to all my friends now that I have a book that's published and available on Amazon.

Lori Sommerfield:

I wanted to note that it's available in both soft copy and eBook formats.

Chris Willis:

That's right. You can read it on your tablet or your Kindle. You can sit there and write notes on it about how brilliant the genius is of the book, right there on your electronic copy. I think that'll be really handy for our listeners.

Lori Sommerfield:

Indeed.

Chris Willis:

Lori, and especially David, thank you very much for being on today's podcast. And of course, I very much appreciate the opportunity to have worked with both of you on the second edition of this book. And of course, thanks to our audience for listening to today's episode as well. Don't forget to visit and subscribe to our blogs, consumerfinancialserviceslawmonitor.com and troutmanpepperfinancialservices.com. And while you're at it, why don't you go ahead and visit us at troutman.com and add yourself to our Consumer Financial Services email list that way you'll get copies of the alerts that we send out as well as invitations to our industry only webinars. And of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.

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