The Consumer Finance Podcast – Fair Lending Shake-Ups: CFPB Vacates Townstone Settlement, FHFA Ends GSEs' Special Purpose Credit Programs
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Guests: Lori Sommerfield and Lane Page
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Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper Locke's Consumer Financial Services Regulatory Practice. And today, we're going to be updating you on a couple of recent fair lending events that have happened under the new administration. But before we jump into that topic, let me remind you to visit and subscribe to our blogs, TroutmanFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And don't forget about all of our other podcasts, *FCRA Focus*, *The Crypto Exchange*, *Payments Pros*, *Unauthorized Access*, and *Moving the Metal*. All those podcasts are available on all popular podcast platforms. 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 fair lending. And fair lending is one of those areas where, I don't know about you, but we're here on the edge of our seats wondering what's going to happen with respect to fair lending under the new Trump administration. And we don't have any grand statement yet. We're just getting little pieces of evidence in to suggest what may be coming on that front, but we want to give those to you in real time and let you know what we think about them.

Joining me to have that conversation today are my colleagues, Lori Sommerfield and Lane Page, both of whom are frequent podcast guests on the show. Lori, Lane, thanks for being on the show to talk with me about this today.

Lori Sommerfield:

Happy to be here, Chris.

Lane Page:

Yeah, thank you very much, Chris.

Chris Willis:

The first of the two events that we wanted to talk to the audience about today was the CFPB's effort to actually vacate a consent order that it entered into in a redlining case, which seems like a really unusual thing for a regulator to do. Lane, can you give the audience some background about what's going on there?

Lane Page:

Sure. At the end of last year, I think November of last year, the CFPB entered into a consent order with Townstone Financial for alleged mortgage redlining in the Chicago area. And this was a big deal because the CFPB hasn't had much history with redlining actions, but an even bigger turn of events, in March of this year, the CFPB and Townstone entered into a joint stipulation to vacate the consent order with the federal court.

And in a press release, the CFPB described its reasoning for moving to vacate the consent order and really kind of attacked the CFPB's own conduct in the prior redlining actions stating various issues with the action, some of them being that there was no basis for initiating it in the first place, that it was politically motivated, that it infringed on the lender's First Amendment rights by going after the owner of the company's political views and personal statements and statements that he had made on radio shows, which were discriminatory according to the CFPB in November of last year. But now, the CFPB is changing its view on what it had done previously.

Chris Willis:

Well, the interesting thing too about the Townstone case is, well, a couple of things. First, if I recall correctly, it was either the first, or one of the first, redlining cases brought against a non-bank mortgage lender. Historically, prior to then, they had all been banks. But more importantly, this improper behavior by the CFPB of bringing the case based on the owner's political beliefs and in the absence of real evidence of redlining happened under the first Trump administration. I mean, this case was brought when Kathy Kraninger was the director of the CFPB, wasn't it?

Lane Page:

Yes, it was, which really is a wild piece of the story. I mean, there are a lot of pieces about it that are pretty astounding. And so, it was brought under the first Trump administration. It was pursued and settled under the Biden administration, but that doesn't – I mean, the reasons that they're criticizing it now are partially because of the reasons they initiated it in the first place, which you're right, was under the Trump administration.

Chris Willis:

Yeah. And there's even an allegation in the CFPB's discussion of this that the staff at the bureau had sort of misled their superiors into thinking the case was better or with more merit than it actually had. Did you see that?

Lane Page:

Yeah, I think so. The allegations from the CFPB now against the CFPB, which is a funny thing to even say, are that they mislead their superiors in an effort to pursue DEI goals, which we know from nonstop Trump administration news that they are going after DEI practices pretty much anywhere they can. So, it's not surprising to see them cite this as a reason for the misconduct, but it is interesting to see them do so with respect to the CFPB under the Trump administration.

Chris Willis:

And at the end of the show, let's return to this idea of the equation between DEI and sentiment against DEI and the administration and fair lending. Because I've never actually thought of those two things as the same, but it looks like there may be an equation of those happening under the new administration, but let's save that for a little bit later. Let's talk about the implications of the move to vacate the Townstone settlement. What should we be thinking about here, Lane?

Lane Page:

I think there are a lot of things to think about. The first one is a really specific question to this case is whether this is a one-off situation and it happened because the CFPB took this action because of facts very specific to this case, or if this is going to suggest a broader trend with the CFPB potentially, the federal government more generally, to undo settlements that have occurred under prior administrations.

Chris Willis:

Yeah, and it seems to me there's two categories of parties who will be very interested in that. One is the category of parties who entered into redlining settlements during the Operation Combating Redlining Initiative that all the federal agencies were in on during the Biden administration and that resulted in a good, what, dozen-plus redlining settlements. I don't remember the exact number, but it was a lot. Are all those now subject to being vacated because they were pursuing DEI goals? I don't know. It would involve other agencies because most of those cases were settled by the Department of Justice. We don't know about that.

The other one is there were quite a few people who entered into consent orders with the CFPB during the last administration and especially towards the tail end of the last administration. I'm sure every one of them believes that the claims against them were without merit or that the merits were massively overblown by the CFPB. I think that's probably true in a lot of those instances. Are those cases all now subject to being vacated in terms of those consent orders? We'll have to wait and see because I'm sure there'll be a lot of requests being made.

Lane Page:

I agree. And I think it is a really interesting question because obviously the facts will differ in every case, but there are a lot of instances particularly towards the end where the CFPB was just trying to get as much news as it could, and they were really pushing companies to settle. A question for you, Chris. If you were an institution that had entered into a consent order with the CFPB during the Biden administration, what would you be thinking about in terms of trying to undo that? What steps would you potentially take? Do you think it's even a good idea to try to do anything about it?

Chris Willis:

I mean, we don't know whether such an effort would be successful yet or not. And frankly, we're not even sure how to communicate with whoever at the CFPB is making those decisions because it's not like the agency's been under a sort of mostly shut down status for several months now. But I don't see that there's any harm in asking. I don't yet have any reason to believe there's going to be a broad-based evaluation to vacate settlement agreements that were reached prior to the administration. But certainly, if there is some sort of special hook with respect to a case, like these parties had the special hook of the owner's political beliefs and being punished for those political beliefs, maybe that would give them a greater chance of getting this kind of attention. But I think we're just going to have to wait and see what happens when other parties try to have their consent orders vacated and see if it works or not, so that we'll know whether that's something that's open to other people or not. But I think people will be trying.

Lane Page:

Right. Yep. I agree. That all makes sense. And I guess, aside from things that have happened in the past, what are your thoughts on what this indicates for future fair lending enforcement, future redlining enforcement at the federal level?

Chris Willis:

Well, I mean, given all of the anti-DEI content that's been put out by the new administration, and the thing that we're going to talk with Lori Sommerfield about in a minute about special purpose credit programs, it's hard for me to believe that there'll be any emphasis on fair lending enforcement at the federal level under this new administration. In my mind, the question is how far in the reverse will it go? Are people at risk if they have special purpose credit programs? Are they at risk for doing statistical analyses of their loan portfolios to look for fair lending disparate impact violations? Is the administration going to try to do a rulemaking that says that piece in Reg B about the effects test and disparate impact is wrong? And so we're going to do away with that. That's kind of what I'm wondering if the new administration is going to do, not whether they're going to do any fair lending enforcement because I think there will be little to none of that.

Lane Page:

Right. Yeah, that makes sense. And you know what? It's hard to talk about what the federal government is doing without talking about what the states are also doing. And your comments really probably put a lot of lenders in a bind because we are pretty sure that certain states are going to try to pick up their fair lending enforcement and their consumer financial services enforcement more generally to take over from what the CFPB is not doing and other agencies are not doing. How does an institution work out those two things? Worried about fair lending enforcement going in the opposite direction with the federal level but still having to comply with fair lending laws because they will be enforced by state agencies.

Chris Willis:

Sure. And I think, first of all, to talk about the premise of your question, there's certainly going to be a lot of motivation among some of the states to do a lot with respect to fair lending because they'll note that there's a vacuum at the federal level if in fact that's what eventuates, but we think that's probably what will happen. But the problem with fair lending cases is those are high-resource, long-term, higher-risk cases for a state regulator because it takes a lot of money and time to investigate one. It requires a lot of technical expertise, the use of outside experts like statistical consultants and things like that.

And then at the end of the day, the legal standard to be applied between disparate impact and business justification and less discriminatory alternatives isn't super clear. So, it's not like you have these cases, it's just laydowns where you know you're going to win the case. It's not like an open and shut, you violated my state's call collection frequency or collection call frequency cap. Those are very easy cases for state regulators to bring, and they like those.

I don't have a high expectation that there'll be tons of fair lending enforcement from the states to match the number of cases that we saw during the Biden administration, especially on redlining cases, which, again, that was a lot of cases. But I think there will be some efforts at the state level to do enforcement.

But what I'm more worried about is state legislation that essentially says, "We hereby amend our state fair lending law to require everybody to do disparate impact analyses and less discriminatory alternative analyses on all credit models," for example. And when you do that, you have to do it annually and report the results of it to the state attorney general. That would make those cases a lot easier for the states to do. They would put a lot of obligation onto the industry that then doesn't require a lot of work by the state regulators. That's really, to me, the only way the states, I think, are going to do a lot of volume of activity on fair lending is if they have legislation that accomplishes something like that.

Lane Page:

Right. Okay. Yeah. It sounds like for most of all of this, we are in a wait-and-see scenario to see what the federal government does and what states do in response.

Chris Willis:

Definitely, but we're also in a wait-and-see posture about what the federal government will do in the next administration. Because people who are in this industry and who've been in it for a long time, now we've seen a couple of cycles of whipsawing with the federal regulators on fair lending. And we're having another one right now, a pretty extreme one. And we had an extreme one in the last administration, I have to say.

Now we know that's going to happen every time the White House changes hands from one political party to the next. And there's always another election less than four years away. And when the federal regulators do investigations or examinations, they necessarily look to the past. They don't look to the future. And so, there's also a pretty powerful reason for parties not to just walk off of fair lending compliance altogether because the statute of limitations under ECOA is five years. And so, you have the next presidential administration, if a Democrat wins the White House, then you could have a five-year look back under ECOA, and this entire administration could be open season for a new administration. And so that really, I think, prevents industry from saying, "Oh, it's a fair lending holiday for the next three years." You know? It's just not realistic to say that because the statute's long enough to encompass the entirety of the preceding administration.

Lane Page:

Right. Thanks. Yeah, that makes sense.

Chris Willis:

There's another news event that we wanted to talk to you about today. And now, Lori, I'm going to bring you into the conversation. One of the most dramatic things I felt about fair lending that occurred during the Biden administration was the very high level of encouragement that the federal regulators gave industry to do special purpose credit programs. And I might even be underselling that a bit, because I think in some instances, they were practically requiring them in the redlining context. But as a result, there were a lot of special purpose credit programs, especially in mortgage, and a lot of those required the cooperation of the GSEs, Fannie and Freddie. But now, the rug's been pulled out from under those programs. Can you tell us what happened?

Lori Sommerfield:

Recently, Bill Pulte, who's the director of the Federal Housing Finance Agency, announced on his account on X that the agency had issued an order requiring the two government-sponsored enterprises that it supervises, and that would be Fannie Mae and Freddie Mac, to terminate special purpose credit programs that they support with financial institutions.

According to the order, the FHFA has determined that the current level of support SPCPs is quote, "inappropriate for regulated entities and conservatorship." And that, of course, is a reference to the FHFA's conservatorship of those GSEs. The directive, which was effective immediately, basically is going to significantly impact banks that have mortgage-related SPCPs. However, the GSEs are permitted under the order to comply with any contractual obligations that they might have about providing prior written notice to lenders about their intent to terminate their participation in the SPCP. But clearly, this is a significant policy shift under the new administration and one that was rather dramatic in terms of the way that it was announced by Director Pulte.

Chris Willis:

Yeah, no kidding. And so just by way of background, let's just refresh the audience on what is the law and the interagency guidance that has happened with respect to special purpose credit programs, both mortgage and non-mortgage.

Lori Sommerfield:

Sure, I'll cover that, Chris. First of all, SPCPs, which by the way, are programs through which financial institutions can consider prohibited basis information when they're determining whether or not to grant credit to economically or socially disadvantaged groups, are specifically authorized under the Equal Credit Opportunity Act (otherwise known as ECOA) and Regulation B, but they're not expressly authorized under the Fair Housing Act.

Nonetheless, in December of 2021, the U.S. Department of Housing and Urban Development issued a legal opinion stating that SPCPs that address home mortgage credit needs for economically disadvantaged groups and that are designed and implemented in compliance with ECOA and Reg B generally don't violate the Fair Housing Act.

And then, a few months later, in February of 2022, multiple federal agencies, which by the way included both HUD and the FHFA, issued interagency guidance in the form of a policy statement that strongly encouraged the use of SPCPs by financial institutions under both ECOA and the Fair Housing Act. And you made reference to that policy statement earlier, Chris.

Chris Willis:

Well, let's go back to that HUD opinion. I remember when it came out. It was jointly requested, as I recall, by the Mortgage Bankers Association and the National Fair Housing Alliance, I think. And so, it then formed the basis for a whole lot of mortgage-related special purpose credit programs. First of all, is there anything in the Fair Housing Act that says anything about special purpose programs?

Lori Sommerfield:

No, there isn't. Not a thing.

Chris Willis:

No. So, what's the status? I know there's a broad-based effort by the administration to revisit and perhaps withdraw regulatory guidance or pronouncements that the new administration doesn't agree with. What's happened with that HUD special purpose credit program statement under the Fair Housing Act?

Lori Sommerfield:

Well, we're not exactly certain what the status is today, Chris. But we do know that since President Trump took office in January, HUD's legal opinion that authorized SPCPs under the Fair Housing Act was subsequently removed from HUD's website. However, we haven't seen any notifications that HUD has actually formally withdrawn the opinion yet. So, that could mean either that HUD is re-examining the opinion to determine whether to retain it, rescind it, or modify it, or perhaps they are consulting with other federal agencies about it.

And notably, the other federal agencies haven't yet taken any action to either rescind or amend the interagency policy statement. But I presume that's also under review. And I wouldn't be surprised to see if the policy statement was rescinded under the Trump administration.

Chris Willis:

Yeah, I think I agree with you. I think it's highly likely, particularly given the fact that there's nothing in the statute with respect to it. Obviously, there's a very strong connection between mortgage-related special purpose programs, which now Fannie and Freddie have said they're not going to do anymore, and the “Combatting Redlining Initiative” that we've talked to this audience about so many times together, Lori. Can you explain what that nexus was? Because I think that's a very important thing for the audience and the industry to understand.

Lori Sommerfield:

Sure. I think you alluded to it before, Chris, in your introductory remarks. But during the preceding administration, the level of support for SPCPs by the federal agencies was incredibly high. And it was to the point that many lenders felt that they needed to actually implement SPCPs, or they were required to do so by their regulator in order to shield themselves from the very aggressive application of the federal fair lending laws that we saw under the Combating Redlining Initiative, which, as you and the audience know, was led by the DOJ.

We're now seeing this complete 180-degree shift with the FHFA's recent order when we compare it to that previous high level of encouragement. We've gone from a status where you almost had a requirement that financial institutions establish SPCPs to now this version that basically they're not encouraged at all. In fact, perhaps looked upon disfavorably.

Chris Willis:

Yeah. And it'll be interesting to see if that actually happens because the FHFA announcement doesn't say to the industry, "No, don't do these." It just says, "We're not doing them with the GSEs." But as a signal, it might mean something. What do you think this portends for mortgage lenders who have mortgage-related special purpose programs? What should they do about this?

Lori Sommerfield:

Well, first of all, let me state as a threshold matter that I think a lot of legal experts felt as though HUD's legal opinion was on somewhat shaky ground because, as you mentioned, there really is no basis for HUD to have found that SPCPs were authorized under the Fair Housing Act. But now, in light of the FHFA’s directive to the GSEs, I think that any bank or financial institution that has a mortgage-based SPCP should revisit their written plans and their business objectives to determine whether any adjustments might be advisable.

For example, they might want to look at eligibility criteria to determine whether those need adjustment. Institutions might also consider whether to even continue offering them. More generally, I think that this directive suggests that instead of the federal agencies looking upon

SPCPs favorably, they're now going to instead increase regulatory scrutiny, particularly for any mortgage-based SPCPs.

Private litigation, though, is also a risk, especially for these mortgage-based SPCPs. Because as we've been noting, there's no statutory provision within the Fair Housing Act that actually authorizes that. And then, of course, there's also the practical risk of SPCPs, if they need to be modified or unwound, which could disrupt business plans in midstream. I think you're looking at a whole host of risks here, Chris, as you and I have discussed. There's regulatory scrutiny, there is private litigation risk, and there's also the practical risks that institutions, particularly with mortgage-based SPCPs, should consider.

Chris Willis:

Let's take that same question, Lori, and now turn to the non-mortgage world. Let's say I had a small business special purpose credit program or some other non-mortgage one, how should I feel about my status of that under the Equal Credit Opportunity Act? Of course, I don't have to worry about the Fair Housing Act for those in light of developments like what we've been talking about on the show today.

Lori Sommerfield:

Well, I think that any SPCP that is created under the authority of ECOA and Regulation B is certainly on firmer legal ground, but I don't think that the administration is going to be encouraging or promoting use of SPCPs. As I previously mentioned, SPCPs are specifically authorized under ECOA and Reg B, so it would take an act of Congress to actually amend ECOA, or it would require the CFPB to amend Reg B to eliminate SPCPs altogether. But I don't think that's likely. I think what's more foreseeable is that the federal agencies would band together and decide to rescind the interagency policy statement encouraging use of SPCPs. Do you agree with that, Chris?

Chris Willis:

Yes, that makes sense. Because I don't feel like the votes are there for them to amend the Equal Credit Opportunity Act to take that out. They'd need 60 votes in the Senate, I think, to do that. And that doesn't seem to exist under the current political situation. I agree with you there.

But let's close out the show, Lori, with the topic that I alluded to earlier, which is the idea that there's an equation in the administration's mind between DEI efforts, which they view as not just bad policy, but as unlawful discrimination, unconstitutional discrimination. You've seen that language from the administration and fair lending, which has to do with enforcement of specific anti-discrimination laws at the federal level, like ECOA and the Fair Housing Act. It's interesting to me to think about how the collision of those two things is going to play out with regulatory oversight at the federal level over the next few years. What's your thoughts on that?

Lori Sommerfield:

Yes, it's such a fascinating question because the federal fair lending laws are still on the books, including the regulations that implement them that are administered both by the CFPB and HUD. Clearly, those agencies have to continue to enforce the law. But I think we're going to see more reverse discrimination cases being brought. There's sort of limited precedent for that in the past, but I think given the anti-DEI environment under the current administration, there's going to be more of a groundswell of support for those types of cases.

But I think that institutions have to proceed, at least as it relates to SPCPs, as though they are able to still support ECOA and Reg B-based SPCPs. But I think you want to revisit the criteria under which those SPCPs are formulated, things like the name of the program, so that it de-emphasizes DEI concepts, like diversity. Inclusion seems to be a safe concept. And I think there are projected class groups that certainly are still in a safe zone, like veterans. We know that the Trump administration is very supportive of veterans, largely speaking. But SPCPs that promote access to credit to certain protected class groups like women, minorities, LGBTQ individuals, I think that those are going to be on shakier ground. I think it's advisable for institutions to go back and revisit their written plans, look at the name of their SPCPs, and try to determine whether any adjustments might be advisable in the current environment.

Chris Willis:

Well, thank you, Lori. And Lane, thank you, too, for being on today's program to talk about these first signs of developments with respect to fair lending under the new administration. We're obviously going to continue watching this here at Troutman Pepper Locke and see what else may happen. And we'll report it to you if it's interesting here on the podcast and on our blogs.

There is one sort of preview I want to give the audience, though. We understand that there's an effort right now for the CFPB to take a holistic look at all the sort of informal guidance that it provided to industry over the course of the last administration on a variety of topics, not just fair lending, but everything else, and to either revise or withdraw that guidance if it's not consistent with the new administration's policy views.

One of those pieces of informal guidance that stands out in my mind with respect to this conversation is the supervisory highlights that came out on Friday right before the administration changed. I mean, literally, the Friday before the inauguration, memorializing the CFPB's views about fair lending, testing, and anti-discrimination measures for credit models under the Equal Credit Opportunity Act. Let's all watch and see if anything happens with that supervisory highlights because I think there's a decent chance that it may. Stay tuned and we'll talk about that whenever anything happens in that regard.

But again, Lori and Lane, thank you for being on the show today. Thanks to our audience for tuning in as well. Don't forget to visit and subscribe to our blogs where we report on all of these things in as close to real time as we can, TroutmanFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And while you're at it, why not visit us on the web at troutman.com? That way, you can add yourself to our Consumer Financial Services email list and get copies of the alerts and advisories 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.