Fair Lending Considerations in a COVID-19 World: Rules Still in Play

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The U.S. banking regulators and state attorneys general have issued several appeals to the financial services industry to assist borrowers in financial distress due to the COVID-19 pandemic. These agencies have publicly stated that they will provide regulatory flexibility regarding accounting, reporting, and regulatory capital rules; credit reporting requirements; billing error resolution timeframes; and electronic credit card disclosure obligations.

Their approach regarding other rules, however, remains seemingly unchanged. As noted in the Office of the Comptroller of the Currency (OCC) National Risk Committee's Spring 2020 Semiannual Risk Perspective, released on June 29, 2020, financial institutions are responsible for complying with fair lending laws and regulations and other consumer protection requirements, which can be particularly challenging during the current economic and public health environment. The report highlights an increase in compliance risk due to, among other reasons, new assistance programs for customers, short timelines for implementation of new practices and procedures, staffing challenges, and higher transaction volumes. With respect to lending-related requests in particular, the report notes that an increase in such requests "could cause breakdowns in controls related to account management, servicing management, flood insurance coverage, credit bureau reporting, and complying with applicable laws and regulations."

The OCC report illustrates the fact that financial institutions need to be aware of the fair lending and other product-specific requirements triggered by the accommodations they make for consumers experiencing financial difficulties. As discussed in the first and second articles in this series on fair lending issues, financial institutions should avoid practices that are unfair, deceptive, or abusive by, for example, self-monitoring to ensure they are treating all similarly situated consumers the same to reduce the risk of explicit prohibited discrimination, as well as unintended disparate treatment. Compliance with these requirements is particularly critical given the current heightened general awareness of discrimination issues and recent public focus on civil rights.

This article focuses on several other rules that are also still in play and must be addressed, including ability-to-pay determinations for card accounts, advance notice, and safety and soundness requirements. As with many such regulatory requirements, fair lending considerations act as an overlay and should be part of any assessment of compliance planning.

ABILITY-TO-PAY DETERMINATION RULE FOR CREDIT CARD ACCOUNTS

Pursuant to the Regulation Z provisions that apply to credit card accounts, a consumer credit card issuer may not open a new account or increase the credit limit on an existing account unless it considers the consumer's ability to make required minimum payments based on the consumer's income or assets and current obligations. 12 CFR § 1026.51(a)(1)(i). This rule applies even if the issuer is considering a line increase on its own accord and not in response to a request from the consumer.

The ability-to-pay analysis must be based on the known facts and circumstances at the time of the application to open a new account or the consideration of the credit line increase on an existing account. Regulation Z specifically calls out as "unreasonable" the issuance of a credit card to a consumer who has no income or assets. These broad and specific requirements create obvious challenges for credit card issuers seeking to assist financially distressed consumers. In the face of potential hurdles, however, credit card issuers can consider creative solutions so as to meet both regulatory concerns and consumer needs. For example, for consumers whose employment or salary has been negatively impacted by COVID-19, an issuer might consider an extension of credit based on non-salary sources of income and types of assets, including:

- Savings account and investment assets;
- Public assistance, including stimulus payments and unemployment benefits;
- Interest or dividends, retirement benefits, alimony, child support, separate maintenance payments, and proceeds from student loans remaining after required payments to the relevant educational institution;
- Income that a non-applicant regularly deposits into the consumer's individual or joint account, rather than using the funds for expenses;
- Income or assets of the other accountholders if the credit card account is a joint account;
- Income or assets of other individuals who are not liable for debts on the credit card account if a Federal or state statute or regulation (e.g., a state community property law) grants the consumer an ownership interest in such income and assets; and
- Income and assets to which the consumer has "a reasonable expectation of access," such as funds that someone else regularly uses to pay for the consumer's expenses. Note that these funds are not permissible sources of income for a credit card issuer to consider in analyzing the ability to pay of a consumer under 21 years old on an individual account unless a Federal or state statute or regulation grants the consumer an ownership interest in the funds. Rather, such a determination for these younger consumers must be made based on the consumer's independent ability to pay unless the consumer has a joint applicant, co-signer, or guarantor who is at least 21 years old. The Official Interpretation of this provision of Regulation Z specifies that compliance with these requirements does not violate Regulation B, which, among other things, prohibits age discrimination.

In designing or implementing any of these alternatives, institutions should be mindful that even-handed application of rules and logic fosters fair lending compliance. In particular, in recognizing non-traditional sources of income or assets, it is important for the institution to develop and confirm an appropriate rationale for why it is doing so. Further, if the institution is being selective among which of various non-traditional sources of income or assets it is accepting, the reasons for such choices should be logically founded. In any disparate impact theory of fair lending recovery, business justifications are more likely to operate as a complete defense if they were developed and documented contemporaneous with the decisions.

CONSUMER ADVANCE NOTICE REQUIREMENTS

The CFPB has issued "guidance" on required regulatory notice requirements during the pandemic through short lists of frequently asked questions (FAQ) on open-end (not home-secured) credit and payments and deposits. The FAQ summarize the change-in-terms notice requirements in Regulation Z at 12 CFR § 1026.9(c)(2)(v)(D), Regulation E at 12 CFR §1005.8(a)(1), and Regulation DD at 12 CFR § 1030.5(a)(1). In light of COVID-19 economic disruptions, these notice requirements arise in a unique posture.

The open-end (not home-secured) guidance notes that compliance with the 45-day advance notice requirement that normally applies to changes of significant terms is not required if the change is an extension of the grace period or reduction of a finance or other charge. These FAQ also remind credit card issuers that a notice of an increase in charges or payments at the end of a temporary hardship arrangement is not required if:

- The issuer clearly and conspicuously discloses the terms of the arrangement before it begins; and
- The rates or fees (or indices and margins in the case of variable rates) at the end of the arrangement do not exceed the rates or fees in place prior to commencement of the arrangement.

Additionally, if the arrangement was entered into orally with the consumer by telephone, this requirement is met by providing a notice to the consumer with the required information as soon as reasonably practicable after the oral disclosure is provided.

For payments and deposits, the FAQ point out that advance notice is not required if the change is favorable to the consumer. Advance notice of 21 days under Regulation E or 30 days under Regulation DD[1] is required for an increase of the fees back to the pre-accommodation amounts. However, institutions can avoid the applicability of this requirement by using discretion to waive the fees instead of officially changing the account terms.

SAFETY AND SOUNDNESS CONCERNS

For institutions under the jurisdiction of the federal financial institution regulatory agencies (Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the OCC, and the National Credit Union Administration), the principles of safety and soundness remain in play. These agencies have issued several individual and joint statements encouraging banks to work with customers affected by COVID-19 by waiving fees, increasing ATM withdrawal limits, easing check-cashing restrictions, increasing credit card limits, offering payment accommodations, and easing terms for new loans; providing assurance of Community Reinvestment Act consideration for these same activities if they help low- and moderate-income customers, small businesses, and small farms; and providing relief regarding negative classification of modified loans. All of these statements, however, note that any such accommodations must be done in a safe and sound manner.

Examiner guidance released on June 23, 2020, by the federal financial regulatory agencies in conjunction with the state bank and credit union regulators, provides some clarity on how the regulators are likely to apply the “safe and sound” standard as institutions operate in light of the ongoing impact of the COVID-19 pandemic. Some of the highlights follow.

The guidance indicates that institutions will continue to receive supervisory ratings based on the existing ratings frameworks and that ratings downgrades, as well as formal and informal enforcement action, are possible. The examiner instructions in the guidance indicate that financial institutions can put themselves in the best position to avoid these negative outcomes by proactively engaging in and documenting the following activities relevant to consumer loan modifications and accommodation programs:[2]

- Timely identify loans substantially affected by the pandemic and recognize any deterioration. Incorporate consideration of the borrower’s repayment ability and financial condition and the prudent and realistic value of any collateral protection in valuing repayment streams.
- Ensure that plans for workouts and for pursuing foreclosure on nonperforming assets are reasonable.
- Continue to follow applicable regulatory reporting instructions, internal accounting policies, and charge-off guidance regarding non-accrual status in regulatory reports.

- Continuously consider relevant information as it becomes available about the collectability of the loan portfolio.

- Review the appropriateness of policies and procedures for credit renewals, extensions, or modifications, which should include appropriate loan risk grades and allow for appropriate accrual status decisions on loans affected by the pandemic.

- Implement procedures for reviewing and updating asset and liability management models for any unusual fluctuations in deposit balances, adjustments to loan payments, changes in interest rates, and other modifications.

The guidance provides some concrete comfort for COVID-19 operations. Among other things, it states that examiners will not criticize institutions for the following in assessing their safety and soundness:

- Appropriate actions taken within the applicable timeframes in good faith reliance on pandemic-related statements released by the federal banking agencies;

- Participating in the Paycheck Protection Program in accordance with Small Business Administration guidelines;

- Engaging in prudent loan modifications and working with borrowers in a safe and sound manner as part of a risk mitigation strategy intended to improve existing loans, even if the ultimate result is adverse credit classification of such loans; and

- Appropriate use of the discount window or other Federal Reserve lending programs, the National Credit Union Administration's Central Liquidity Facility, or the institution's liquidity buffer to support economic recovery, in accordance with its liquidity risk management framework.

There is nothing in the guidance that particularly addresses the issue of fair lending. On a general level, this means that existing legal requirements and guidance remain in full effect. So, while the guidance offers some flexibility and encouragement for responses to COVID-19, it is tempered, as one would expect, with regulatory expectations of compliance with the existing legal framework.

[1] The Regulation E requirement can be followed if both apply.
[2] The guidance also directs examiners to review other management actions with respect to a variety of other topics, including asset quality and classification, internal controls, long-term business strategy, and liquidity, among others.

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