

March 25, 2022

CFPB Updates UDAAP Examination Procedures

Changes Broaden Analysis of Unfair Acts or Practices to Embrace Discriminatory Conduct and Signal Agency's Continued Focus on Fair Lending Issues, Including in Algorithms

SUMMARY

On March 16, 2022, the Consumer Financial Protection Bureau (“CFPB”) updated the section of its examination manual covering unfair, deceptive, or abusive acts or practices (“UDAAP”). The changes are almost exclusively focused on inserting language addressing “discrimination” as an unfair practice and providing related guidance to examiners. The manual updates reflect an expansive—and as yet legally untested—view that the unfairness doctrine provides the CFPB with authority to examine for and bring enforcement actions based on discrimination beyond its existing authority under the Equal Credit Opportunity Act (“ECOA”). Under the updates, this authority encompasses (i) all consumer financial products and services, and (ii) a broader universe of persons who provide such products and services than has historically been the case. At the same time, the CFPB does not specify the bases on which discrimination is prohibited, leaving uncertainty as to whether the CFPB intends to focus on the bases prohibited under existing federal fair lending law or also to consider discrimination on other bases. The manual updates also signal that future UDAAP examinations will include close scrutiny of any algorithms used in connection with consumer products and services for potential bias. The CFPB did not publish the updates for public comment.

Because the manual provides direction to CFPB examiners on how to assess compliance with the prohibition on unfair, deceptive, or abusive practices, the updates should serve as an important guide to all persons that are subject to CFPB examination. The manual may also inform the views of other agencies that have authority to enforce prohibitions on unfair acts or practices (including the prudential banking supervisors and the Federal Trade Commission (“FTC”)), and therefore the update should also be of

interest to a much broader array of persons who provide products and services to consumers but who are not supervised by the CFPB.

BACKGROUND

The Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”)¹ makes it unlawful for any covered person or service provider to engage in any unfair, deceptive, or abusive act or practice.² The Dodd-Frank Act also provides the CFPB with rulemaking authority to define and prevent unfair, deceptive, and abusive acts and practices, along with enforcement authority to prevent covered persons and service providers from engaging in such acts and practices.³ This authority has not previously been interpreted by the CFPB as prohibiting discrimination. ECOA⁴ and the Fair Housing Act (“FHA”)⁵ are the two principal federal statutes outlawing discrimination in the provision of consumer financial products and services. In that context, both ECOA and the FHA apply to discrimination in *lending* and related activity. Specifically, ECOA prohibits discrimination in any credit transaction on bases that include race, color, religion, national origin, sex, marital status, age, and receipt of public benefits.⁶ The FHA makes it unlawful to discriminate in residential real estate-related transactions, including mortgage lending, on the basis of race, color, religion, national origin, sex, familial status, or disability.⁷ The CFPB has rulemaking and enforcement authority under ECOA,⁸ but does not have any jurisdiction to enforce the FHA, which is administered by the Secretary of Housing and Urban Development.⁹ In addition to these lending-related antidiscrimination statutes, the Civil Rights Act of 1991 provides for civil actions for race-based discrimination.¹⁰

SUMMARY OF MANUAL UPDATES

In defining an act or practice as unfair, and therefore unlawful, the CFPB must have a reasonable basis to conclude that: (i) the act or practice causes or is likely to cause substantial injury to consumers; (ii) the injury is not reasonably avoidable by consumers; and (iii) the injury is not outweighed by countervailing benefits to consumers or competition.¹¹ The manual updates state that discriminatory behavior may implicate the first two prongs of this test. As to the first prong, “[f]oregone monetary benefits or denial of access to products or services, like that which may result from discriminatory behavior,” may constitute a substantial injury.¹² In addition, emotional impacts or dignitary harms caused by discriminatory conduct may also amount to or contribute to substantial injury.¹³ As to the second prong, the manual updates state, without elaboration, that “consumers cannot reasonably avoid discrimination.”¹⁴ The updates do not address how a potentially discriminatory practice would be evaluated under the third prong.

The balance of manual updates explain the relationship of the prohibition on UDAAP to other consumer protection laws and specify additional examination objectives and procedures. As to the former, the updates explain that a discriminatory act or practice that is unfair, deceptive, or abusive “may also violate other antidiscrimination laws, such as ECOA.”¹⁵ Equally, the updates state that a discriminatory act or

SULLIVAN & CROMWELL LLP

practice to which the fair lending laws do not apply may nonetheless violate the prohibition on unfair, deceptive, or abusive acts or practices.¹⁶ For example, “not allowing African-American consumers to open deposit accounts, or subjecting African-American consumers to different requirements to open deposit accounts, may be an unfair practice even in those instances when ECOA does not apply.”¹⁷ Similarly, UDAAP’s prohibition on discrimination would apply to servicing, collection, consumer reporting, payments, and remittances.¹⁸

In addition, the updates include identifying discriminatory acts or practices as among UDAAP examination objectives and list a number of additional procedures examiners should follow with a view to achieving that objective. These new procedures include requesting “[d]ocumentation regarding the use of models, algorithms, and decision-making processes used in connection with consumer financial products and services,” customer demographic information for products and services, and demographic research or analysis relating to marketing or advertising.¹⁹ The updated manual directs examiners to consider, among other things, whether the examinee:

- “has a process to prevent discrimination in relation to all aspects of consumer financial products or services,” including whether it evaluates all policies, procedures and processes for discrimination prior to implementation or change and monitors for discrimination post-implementation;
- periodically reviews, tests and monitors the decision-making processes it uses for potential UDAAP concerns, including discrimination, and mitigates any such concerns;
- targets or excludes consumers from products and services, or offers different terms and conditions, in a discriminatory manner,
- provides appropriate training for customer service personnel to prevent discrimination;²⁰
- demonstrates demographic preferences;
- engages in targeted advertising or marketing in a discriminatory way;
- uses decision-making processes that result in discrimination; or
- fails to evaluate and make corrections to prevent discrimination.²¹

IMPLICATIONS

The updated manual’s inclusion of discriminatory conduct as an unfair act or practice and its characterization of UDAAP as an antidiscrimination law are, in our view, both novel and potentially significant, and may foreshadow new regulatory or enforcement activities. The CFPB’s instruction to examiners to scrutinize models and algorithms is also notable. As to these matters, we offer several observations.

- 1) Compliance efforts in the financial services sector have historically focused primarily on discriminatory conduct in lending-related activities and ensuring compliance with ECOA and the FHA. To facilitate that compliance, banks and other financial services providers have developed complex systems and controls designed to identify all forms of potentially unlawful discrimination *under those laws*—overt

SULLIVAN & CROMWELL LLP

discrimination, disparate treatment, and disparate impact. As a result, some financial services providers may not presently have in place an adequate framework to demonstrate the absence of discrimination in products and services unrelated to lending. The manual updates strongly suggest that financial services providers examined by the CFPB should ensure that their antidiscrimination compliance efforts, including risk assessment processes, appropriately extend to *all* consumer financial products and services, including deposit products and remittance services, as well as related marketing and advertising efforts. Indeed, as the updated manual states, discrimination in the opening of deposit accounts may not be prohibited by ECOA, but may be considered an unfair act or practice under UDAAP.

- 2) The incorporation of discrimination into the unfairness doctrine suggests that the CFPB is attempting to broaden federal regulatory prohibitions on discrimination—at least with respect to consumer financial products and services—to encompass not only new products, as mentioned above, but also new entities. More specifically, ECOA generally applies to “creditors” and the FHA generally applies to residential real estate-related matters. Dodd-Frank’s prohibition on unfair practices, in contrast, encompasses *any person* that offers or provides a consumer financial product or service and any person that provides a material service to such a covered person in connection with that product or service.²² We are not aware of any case law or regulations confirming that discrimination (on the basis of race, ethnicity, gender or otherwise) is prohibited as an unfair act or practice under either the Dodd-Frank Act or under the comparable Section 5 of the FTC Act. In this context, we note that the examination manual does not have the status of a regulation, but may be considered supervisory guidance. Under the CFPB’s “Statement on Supervisory Guidance,”²³ “supervisory guidance does not have the force and effect of law” and the CFPB does not take enforcement action based on supervisory guidance; instead, guidance “outlines the [CFPB’s] supervisory expectations or priorities and articulates the [CFPB’s] general views regarding appropriate practices....”
- 3) Although ECOA and the FHA specify the classes of persons who are protected from discrimination, the updated manual does not. It is unclear what, if any, existing body of law the CFPB would refer to in determining whether a particular basis for discrimination is unlawful or particular conduct is discriminatory under an unfairness analysis. For example, it is unclear whether prohibited bases would be limited to those specified under ECOA (race, color, religion, national origin, sex, marital status, age, and receipt of public benefits) or also include others, such as citizenship. Similarly, the manual updates do not specify whether or how the overt discrimination, disparate treatment, and disparate impact jurisprudence of ECOA and the FHA should be incorporated into the unfairness analysis.
- 4) The updated manual’s attention to algorithms is consistent with a long-standing priority of CFPB Director Rohit Chopra, as we noted in our recent [client memorandum](#) on the CFPB’s February 23, 2022 release outlining options for quality-control standards for automated valuation models (“AVMs”). In that

SULLIVAN & CROMWELL LLP

release, the CFPB states that “algorithmic systems such as AVMs, are subject to federal nondiscrimination laws, including [ECOA and the FHA].” Given Director Chopra’s interest, the views expressed in the CFPB release, and the manual’s characterization of the unfairness doctrine as prohibiting discrimination, we believe financial services providers should expect future CFPB examinations to include close scrutiny for potential bias in any algorithms used in connection with consumer financial products and services.

- 5) There have been prior indications that the unfairness doctrine could be used to combat discrimination. For example, a 2021 FTC blog post suggested that the unfairness doctrine could be used to prohibit discrimination, and a 2014 FTC Report recommended that data brokers take precautions to prevent downstream users of data from utilizing the data for “unlawful discriminatory purposes” and indicated that at least one commissioner at the time “believe[d] that to the extent that information is being used for unlawful discriminatory purposes, the Commission’s law enforcement authority is the appropriate vehicle to address this problem.”²⁴
- 6) Whether the unfairness doctrine is flexible enough to prohibit discrimination is ultimately a judicial determination. However, courts have frequently noted in FTC cases interpreting the FTC’s comparable unfairness authority that Congress “designed the term as a ‘flexible concept with evolving content,’ . . . and ‘intentionally left [its] development to the Commission.’”²⁵
- 7) Other agencies have authority to enforce prohibitions on unfair acts or practices, including the prudential banking agencies. It is possible the CFPB’s view will influence the future actions of those agencies.

* * *

ENDNOTES

- 1 Public Law 111-203, 124 Stat. 1376 *et seq.* (2010).
- 2 *Id.* at Title X, § 1036 (codified at 12 U.S.C. § 5536). “Covered person” means any person that engages in offering or providing a consumer financial product or service, and any affiliate of such a person acting as a service provider to such person. 12 U.S.C. § 5481(6). “Service Provider” means any person that provides a material service to a covered person in connection with the offering or provision by such person of a consumer financial product or service. 12 U.S.C. § 5481(26).
- 3 *Id.* at Title X, § 1031 (codified at 12 U.S.C. § 5531) and Title X, § 1025 (codified at 12 U.S.C. § 5515). The CFPB has examination and primary enforcement authority with respect to insured depository institutions with total assets of more than \$10 billion and their affiliates. The Federal banking agencies have primary enforcement authority for insured depository institutions with total assets of \$10 billion or less and their affiliates. The CFPB also has enforcement authority over all non-bank covered persons and examination authority over certain non-bank covered persons.
- 4 15 U.S.C. § 1691 *et seq.*
- 5 42 U.S.C. § 3061 *et seq.*
- 6 15 U.S.C. § 1691(a).
- 7 42 U.S.C. § 3605(a). The FHA’s prohibitions also encompass discrimination in a variety of residential real estate-related matters not involving lending.
- 8 *Id.* at §§ 1691b and 1691c(a)(9).
- 9 *Id.* at §§ 3612–14.
- 10 42 U.S.C. § 1981 *et seq.*
- 11 12 U.S.C. § 5531. *See also* Manual at 1–2. The CFPB may also “consider established public policies as evidence” in determining whether an act or practice is unfair, but “[s]uch public policy considerations may not serve as a primary basis” for an unfairness determination. 12 U.S.C. § 5531(c)(2).
- 12 Manual at 2.
- 13 *Id.*
- 14 *Id.*
- 15 *Id.* at 10.
- 16 *Id.*
- 17 *Id.*
- 18 *See* CFPB, *CFPB Targets Unfair Discrimination in Consumer Finance*, March 16, 2022, available at <https://www.consumerfinance.gov/about-us/newsroom/cfpb-targets-unfair-discrimination-in-consumer-finance/>.
- 19 *Id.* at 12.
- 20 *Id.* at 13.
- 21 *Id.* at 15.
- 22 12 U.S.C. § 5481(6), 12 U.S.C. § 5481(26)(A).
- 23 12 C.F.R. § 1074.

ENDNOTES (CONTINUED)

- ²⁴ See FTC Blog Post, *Aiming for truth, fairness, and equity in your company's use of AI*, April 19, 2021 ("The FTC Act prohibits unfair or deceptive practices. That would include the sale or use of – for example – racially biased algorithms."), available at <https://www.ftc.gov/business-guidance/blog/2021/04/aiming-truth-fairness-equity-your-companys-use-ai>; FTC, *Data Brokers: A Call for Transparency*, at 55 (2014), available at <https://www.ftc.gov/system/files/documents/reports/data-brokers-call-transparency-accountability-report-federal-trade-commission-may-2014/140527databrokerreport.pdf>.
- ²⁵ *FTC v. Wyndham Worldwide Corp.*, 799 F.3d. 236, 243 (3rd Cir. 2015).

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.