Bridging the divide digest: Positioning purpose and profit through financial inclusion

Regulatory developments in the financial services industry (FSI) on financial inclusion

Leading off

The financial inequities that disproportionally have an impact on disenfranchised communities have become more salient as the world recovers from a global pandemic while also navigating economic uncertainty. With the world edging toward a potential global recession, many lower-income families are struggling to keep up with inflation and are faced with rising borrowing costs, making it difficult for households to make ends meet. In an economic situation like this, financial inclusion—as a solution—can strengthen the availability of financial resources and tools to those who need it the most and promote economic growth in underdeveloped areas of the nation. With the right coordination and support from key stakeholders in the public and private sectors, these efforts can help to accelerate economic mobility for lower-income populations.

As a follow up to our March 2023 financial inclusion digest, this newsletter provides an overview of the latest regulatory developments seen across the FSI industry. In our view, regulators are focusing on increasing transparency of lending practices through tightened disclosure requirements, there are Federal Housing Finance Agency (FHFA) plan updates on the horizon, and several other notable regulatory changes are commencing. Read the sections below to garner deeper insight into how these regulatory events could potentially affect your business.

CFPB finalizes rule to create a new data set on small business lending in America[1]

To increase transparency in small business lending, promote economic development, and combat unlawful discrimination, the Consumer Financial Protection Bureau (CFPB) has issued a long-anticipated small business lending rule by amending Regulation B, which will implement changes to the Equal Credit Opportunity Act (ECOA) made by section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). These changes set forth the requirements that all covered financial institutions[2] will be required to collect and report to the CFPB on information about the small business credit applications they receive, including geographic and demographic data, lending decisions, and the price of credit.[3]

This new data collection rule will also support the anticipated release of a revised Community Reinvestment Act (CRA) regulation, which encourages certain financial institutions to make a concerted effort to meet the credit needs of the communities in which they operate. The Federal Reserve Board of Governors (FRB), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) issued a notice of proposed rulemaking (NPR) on May 5, 2022.[4] We expect an interagency final rule on the CRA sometime this year.

The objective of these rule enhancements is to create a more comprehensive database that provides increased transparency and insight into some of the lending practices exercised by financial institutions. Access to this information will equip regulators with additional tools to assess for potential discrimination and may ultimately result in enforcement actions. The regulatory attention created by this new data source should also provide financial institutions with information on where lending opportunities exist and incentivize them to make a more diligent effort to engage and lend capital to small minority- and women-owned businesses, family farms, and other underserved business community members.

Covered financial institutions and covered credit transactions: The requirements of the final rule apply to lenders that approve more than 100 covered small business loans per year, which accounts for more than 95% of small business loans by banks and credit unions. It will help provide a comprehensive view of small business lending. The rule also covers several forms of credit, including closed-end loans, lines of credit, business credit cards, online credit products, and merchant cash advances by banks, credit unions, and other lenders.

Data field expansion: Demographic data points related to the applicant's ownership have been extended to include (1) minority-, women-, and LGBTQI+-owned businesses and (2) the ethnicity, race, sex, and gender of the applicant's principal owners. The final rule requires a covered financial institution to report these data points solely from the demographic information collected from an applicant. Financial institutions are not required or permitted to report on observations that are either subjective or based on a visual interpretation of an applicant's physical attributes, surname, or any other basis (including demographic information provided for purposes that are non-lending related). The final rule also requires a covered financial institution to inform an applicant, either through the delivery of a disclaimer or verbal disclosure, that the financial institution is not permitted to discriminate based on an applicant's responses about its minority-owned, women-owned, or LGBTQI+-owned business status; responses about any principal owner's ethnicity, race, or sex; or whether the applicant provides this information.

Firewall and reporting requirements: The final rule requires financial institutions to report data to the CFPB by June 1 of the following year in which the financial institution collected the data. The rule also implements a requirement to restrict persons involved in making any determination on the application from having access to the demographic-related data. This, in conjunction with the regulatory submission requirements, creates a need to manage and protect multiple data sets, including the use of upfront (full), middle (masked), and end (enriched) data.

Tiered compliance dates: The compliance dates are tiered depending on the number of covered transactions that a financial institution originated in 2022 and 2023. For in-scope institutions with at least 2,500 covered transactions, the first reports are due October 1, 2024. Financial institutions with lower origination volumes will begin collection and reporting activities in later years.

Third-party tools: The final rule allows financial institutions to work with third-party vendors, including industry consortia, to develop services and technologies that will aid in collecting and reporting data.

In addition, the CFPB issued a policy statement emphasizing that lenders should not discourage applicants from providing demographic or ownership data. The statement goes even further to describe its future analysis of particular responses to identify steering, improper interference, or other potential discouragement (e.g., very high rates of "I do not wish to provide this information" relative to similar lenders). The statement reminds lenders of their responsibilities to identify and respond to potential indicators of discouragement in their practices, policies, and procedures. If applicants are discouraged, lenders may be subject to supervisory sanction or enforcement, including fines.

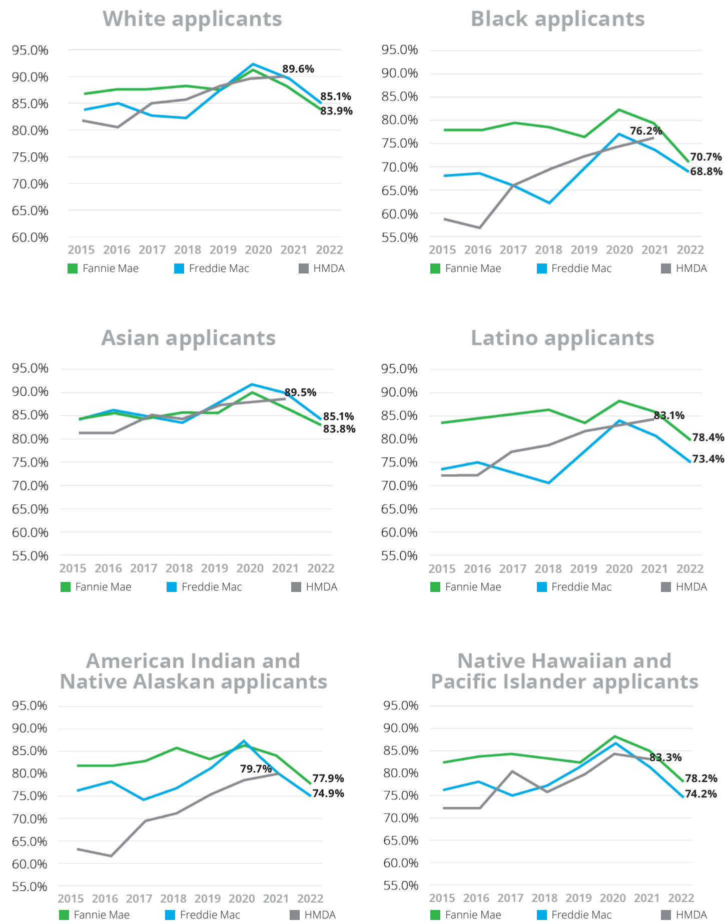
FHFA announces updated equitable housing finance plans for Fannie Mae and Freddie Mac and releases updated enterprise fair lending data

On April 5, the Federal Housing Finance Agency released updates to Fannie Mae and Freddie Mac's (the Enterprises) Equitable Housing Finance Plans. The plans were originally released in 2022 and contain the Enterprises' goals and actions to advance equity in housing finance.

The updated plans include the following actions and goals, among others:

- Updates to the Enterprises' 2022–2024 plans include, but are not limited to:
  - **Including the Latino Housing Journey** and actions to remove barriers experienced by Latino renters and homeowners in Fannie Mae's plan.
  - **Enhancing focus on ensuring existing borrowers receive fair loss mitigation support** and outcomes through monitoring and developing strategies to close any gaps.
  - **Providing financial capabilities coaching** to build credit and savings.
  - **Supporting locally owned modular construction facilities** in communities of color.
  - **Increasing the reach of the Enterprises' Special Purpose Credit Programs** to support homeownership attainment and housing sustainability in underserved communities.
- The Enterprises' released performance reports that track their progress on last year's plans. The Enterprises made progress in advancing equity in their automated underwriting systems by including rental payments, cash flow underwriting, and advanced statistical techniques. Model fairness improved as a result.
- In addition, the FHFA released an updated Enterprise Fair Lending Dashboard.[5] It categorizes single-family applications (figure 1) and loans (figure 2) by race and ethnicity.

Figure 1. Mortgage application approval rates



Source: FHFA Fair Lending Report, data as of April 5, 2023.

Other notable legislative and regulatory developments

House passes three bipartisan financial services bills[6]

In January, the US House of Representatives passed several pieces of bipartisan financial services legislation among which are initiatives to combat the financial exploitation of seniors and other vulnerable adults, streamline federal credit union board meeting requirements, and increase access to capital for rural small businesses.

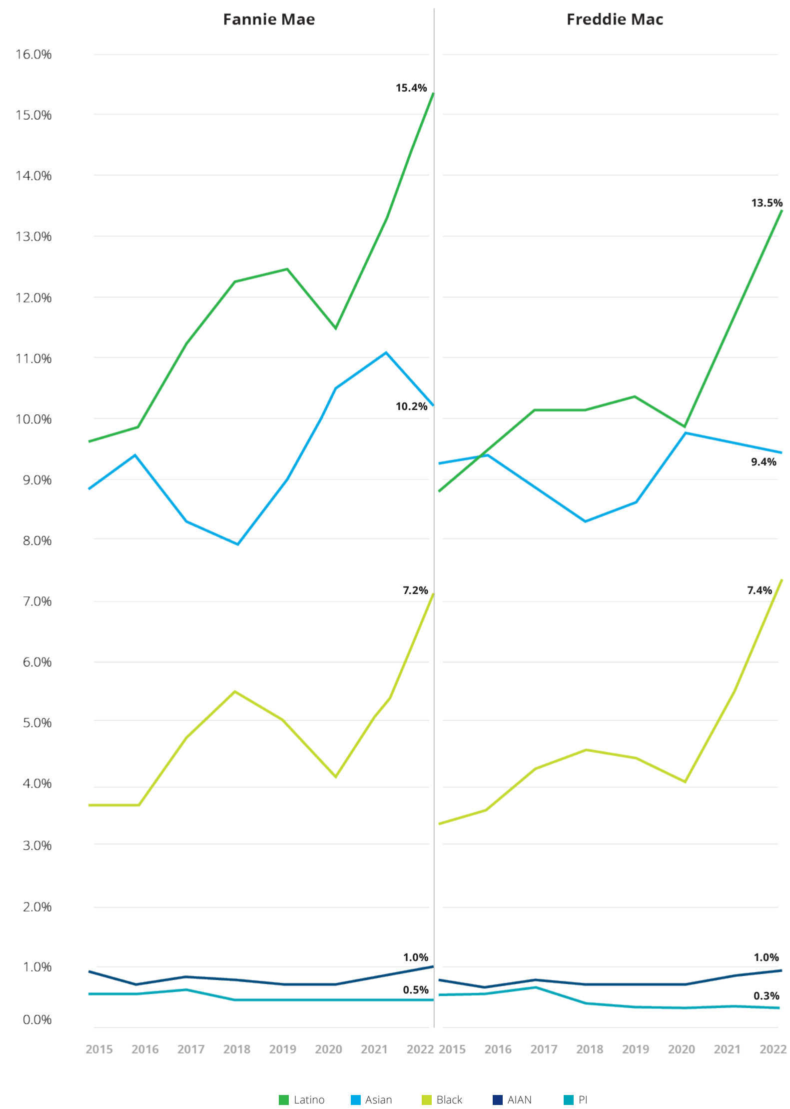
The financial services bills passed by the House include:

1. **H.R. 500, the Financial Exploitation Prevention Act:** Allows for the delay of the redemption of a security issued by an open-end investment management company if the company reasonably believes the redemption involves the financial exploitation of an individual age 65 or older or an individual age 18 or older who is unable to protect his or her own interests.
2. **H.R. 582, the Credit Union Board Modernization Act:** Reduces the frequency of required board meetings for federal credit unions with demonstrated strong risk management practices from monthly to at least six meetings annually, with at least one meeting held during each fiscal quarter. New credit unions and credit unions with a low soundness rating must meet monthly.
3. **H.R. 298, the Expanding Access to Capital for Rural Job Creators Act:**Requires the Advocate for Small Business Capital Formation within the Securities and Exchange Commission (SEC) to report on issues encountered by rural-area small businesses.

New York Department of Financial Services adopts updated regulation for disclosure requirements for commercial financing[7]

On February 1, the New York State Department of Financial Services (NYDFS) adopted the regulation implementing the Commercial Finance Disclosure Law (CFDL), which mandates standardized disclosures for commercial financing below a certain principal amount to address the lack of standardized disclosures in small business lending. The obligation to provide any disclosures under the CFDL applies if the recipient's business is principally directed or managed from the state of New York.

Figure 2. Loan acquisition share



Source: FHFA Fair Lending Report, data as of April 5, 2023.

The CFDL requires certain providers of commercial financing to provide standardized disclosures to potential borrowers at the time financing offers are extended, which will help businesses and individuals understand and compare the terms of different commercial financing offers. The CFDL also has an annual reporting requirement beginning in April 2025 of certain rate information to the Superintendent of the NYDFS. The regulation provides specific instructions to commercial financing providers on how to comply with the CFDL. Among its provisions, the regulation:

- **Provides detailed definitions for terms** used in the CFDL and in the regulation itself.
- **Explains how providers should calculate the finance charge and annual percentage rate.**
- **Sets forth formatting requirements for disclosures** required by the CFDL, both generally and specifically for the following types of financing:
  - Sales-based,
  - Closed-end,
  - Open-end,
  - Factoring transaction,
  - Lease, and
  - General asset-based.
- **Describes how the CFDL's disclosure threshold of $2,500,000 is calculated.**
- **Details certain duties of financers and brokers** involved in commercial financing.
- **Prescribes a process under which certain providers calculating estimated annual percentage rates will report data** to the Superintendent. This data relates to actual retrospective annual percentage rates of completed transactions to facilitate accurate estimates for future transactions.

McHenry announces Financial Services Committee Republican ESG Working Group[8]

On February 3, 2023, Patrick McHenry, chairman of the House Financial Services Committee, announced the creation of a Republican Working Group to counter environmental, social, and governance (ESG) proposals being pushed by progressives. The group will be led by the Committee's Oversight and Investigations Subcommittee Chairman Bill Huizenga (MI-04), who stated that the group will focus its efforts on protecting the financial interests of investors and ensuring that American capital markets remain strong. The group's objectives include reining in the SEC's regulatory overreach, reinforcing the materiality standard as a pillar of the disclosure regime, and holding market participants accountable for misusing the proxy process. The working group will coordinate Republicans' response to the ESG movement through education and policy development across the committee's jurisdiction and throughout the broader House Republican conference.

Note: This is a brief spotlight on current industry ongoings and not Deloitte's point of view.

Key takeaways

Although financial inclusion, as a solution to drive greater economic parity across society, is gaining momentum across all sectors in FSI, and innovative policy ideas are showing promise, there is still a considerable amount of work that needs to be done. A lot of the responsibility to make structural changes to how we view and combat economic disparities in the United States relies on the federal regulators' ability to penalize inaction. These measures, at the very least, should be focused on lowering the barriers to participation, increasing financial literacy, eliminating discriminatory practices, and improving the regulatory landscape overall. In this issue, we've noted several aspects of the ongoing wave of regulatory initiatives to address potential inequities that include the following:

- The CFPB has finalized a rule required by Congress to support the economic growth, combat illegal discrimination, and ensure a smooth transition to collect small business lending data from lenders.
- The FHFA announced updates to the Enterprises' Equitable Housing Finance Plans for 2023 to identify and address barriers to sustainable housing opportunities, including the Enterprises' goals and actions to advance equity in housing finance for the next three years.
- US House of Representatives passed three bipartisan financial services bills to combat the financial exploitation of seniors and other vulnerable adults, streamline federal credit union board meeting requirements, and increase access to capital for rural small businesses.
- The NYDFS adopted a new regulation relating to disclosure requirements for commercial financing to address the lack of standardized disclosures in small business lending. A new law passed mandates standardized disclosures for commercial financings below a certain principal amount.
- Chairman McHenry of the House Financial Services Committee announced the formation of a Republican Working Group to develop a comprehensive approach to ESG that protects the financial interests of everyday investors and ensures the capital markets remain the envy of the world.

Additional Deloitte perspective on financial inclusion

For additional insight, please see our ongoing series on financial inclusion and the impact it has on the financial services industry and the broader economy.

- Deloitte's Center of Regulatory Strategy Consumer Protection and Financial Inclusion Hub
- Driving purpose and profit through financial inclusion
- Advancing social and economic goals with global financial inclusion
- Accelerating toward greater financial inclusion
- The Consumer Financial Protection Bureau (CFPB) underscores the application of anti-discrimination law throughout the credit life cycle
- Additional Deloitte resources

Endnotes

1. Consumer Financial Protection Bureau (CFPB), "CFPB finalizes rule to create a new data set on small business lending in America," press release, March 30, 2023.
2. The term "covered financial institution" written in the context of the final rule is used to describe any business entity that engages in small business lending, including depository institutions (i.e., banks, savings associations, and credit unions), community development financial institutions, and Farm Credit System lenders, among other entity types that provide a similar service in the financial marketplace.
3. CFPB, "Small business lending under the Equal Credit Opportunity Act (Regulation B)," March 30, 2023.
4. Board of Governors of the Federal Reserve System (FRB), "Community Reinvestment Act Proposed Rulemaking," August 5, 2022.
5. FHFA, "Fair lending data," last updated April 5, 2023.
6. House Financial Services Committee, "House passes three bipartisan financial services bills," press release, January 30, 2023.
7. New York State Department of Financial Services (NYDFS), "Superintendent Adrienne A. Harris adopts updated regulation for disclosure requirements for commercial financing," February 11, 2023.
8. House Financial Services Committee, "McHenry announces Financial Services Committee Republican ESG Working Group," press release, February 3, 2023.

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