

Board of Governors of the Federal Reserve System

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# The Board Can Improve the Efficiency and Effectiveness of Certain Aspects of Its Consumer Compliance Examination and Enforcement Action Issuance Processes



**Office of Inspector General**  
Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection



## Office of Inspector General

Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection

Executive Summary, 2021-SR-B-012, October 6, 2021

# The Board Can Improve the Efficiency and Effectiveness of Certain Aspects of Its Consumer Compliance Examination and Enforcement Action Issuance Processes

## Findings

The Federal Reserve System's consumer-focused supervisory activities seek to promote a fair and transparent financial services marketplace and to ensure that the state member banks within its jurisdiction comply with applicable federal consumer laws and regulations. The Board of Governors of the Federal Reserve System's Division of Consumer and Community Affairs (DCCA) is responsible for executing these activities. We found that DCCA can improve the efficiency and effectiveness of certain aspects of the consumer compliance examination and enforcement action issuance processes.

Specifically, we found that DCCA can improve the efficiency and effectiveness of these processes for unfair or deceptive acts or practices (UDAP) and fair lending matters. We believe that the lengthy UDAP and fair lending review processes and the resulting prolonged examinations detract from the effectiveness of these programs by adversely affecting consumers, examiners, and supervised institutions and increasing reputational risk for the System. We believe that DCCA can improve the UDAP review processes by developing formal performance goals and target time frames, establishing criteria for when DCCA must review a potential UDAP matter, and providing guidance and training to Federal Reserve Bank consumer compliance supervision personnel. We acknowledge that DCCA has recently made efforts to improve the timeliness of the fair lending review processes by establishing new performance measures and targets as well as refining the criteria for delegating certain fair lending reviews to the Reserve Banks. However, we believe that DCCA can further enhance these processes by developing additional training to help acclimate Reserve Bank staff and examiners to their newly delegated roles and responsibilities. In addition, DCCA should assess the staffing structure and approach of its Fair Lending Enforcement and UDAP Enforcement sections. We also found that DCCA can enhance transparency in the UDAP and fair lending examination and enforcement action issuance processes by clarifying expectations for communicating with key stakeholders.

## Recommendations

Our report contains recommendations designed to enhance the efficiency and effectiveness of the Board's and the Reserve Banks' consumer compliance examination and enforcement action issuance processes for UDAP and fair lending matters. In its response to our draft report, the Board concurs with our recommendations and outlines actions that have been or will be taken to address each recommendation. We will follow up to ensure that the recommendations are fully addressed.

## Purpose

We conducted this evaluation to assess the efficiency and effectiveness of the Board's and the Reserve Banks' consumer compliance examination and enforcement action issuance processes, including the processes pertaining to UDAP and fair lending matters. This evaluation covered these processes for state member banks with total assets of \$10 billion or less. Our scope did not include assessing the appropriateness of substantive outcomes related to the Board's review of UDAP and fair lending matters, including whether enforcement actions were warranted.

## Background

The Board delegates to each Reserve Bank the authority to supervise certain financial institutions located within the Reserve Bank's district. Reserve Bank consumer compliance examination staff help execute the Board's consumer compliance supervision program, and DCCA oversees these delegated responsibilities. DCCA's *Consumer Compliance Handbook* describes UDAP and fair lending as two of the most significant consumer compliance risk areas for financial institutions. The handbook states that violations of these laws and regulations often cause significant consumer harm and pose legal, financial, and reputational risks to a supervised institution. Enforcement actions may be used to address UDAP or fair lending matters.



**Office of Inspector General**

Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection

Recommendations, 2021-SR-B-012, October 6, 2021

## The Board Can Improve the Efficiency and Effectiveness of Certain Aspects of Its Consumer Compliance Examination and Enforcement Action Issuance Processes

### Finding 1: DCCA Can Improve the Efficiency and Effectiveness of Its Consumer Compliance Examination and Enforcement Action Issuance Processes for UDAP Matters

Number	Recommendation	Responsible office
1	Revise the approach for conducting UDAP reviews by <ol style="list-style-type: none"><li>reassessing the current approach for conducting UDAP reviews.</li><li>establishing additional formal performance measures or targets for completing steps within the UDAP review process.</li><li>defining criteria for determining when DCCA must review a potential UDAP matter.</li><li>issuing guidance consistent with the results of that assessment.</li></ol>	Division of Consumer and Community Affairs
2	Update the June 2012 internal UDAP guidance to reflect program changes that have occurred since establishing the UDAP Enforcement section.	Division of Consumer and Community Affairs
3	Develop templates and other training materials that include case studies on UDAP matters for the Reserve Banks to distribute to their UDAP specialists and consumer compliance examiners. After developing the templates and training materials, DCCA should <ol style="list-style-type: none"><li>define the frequency for conducting periodic training.</li><li>define a plan for providing case studies on a periodic basis to highlight emerging risks as well as frequent or common cases.</li></ol>	Division of Consumer and Community Affairs
4	Assess the current level of staffing within the UDAP Enforcement section to determine whether staffing is appropriate to efficiently and effectively conduct UDAP reviews. As part of this assessment, consider the effect of prospective changes regarding how DCCA selects and prioritizes UDAP reviews.	Division of Consumer and Community Affairs

**Finding 2: DCCA Can Improve the Efficiency and Effectiveness of Its Consumer Compliance Examination and Enforcement Action Issuance Processes for Fair Lending Matters**

<b>Number</b>	<b>Recommendation</b>	<b>Responsible office</b>
5	Develop additional training to acclimate Reserve Bank staff and examiners to new roles and responsibilities resulting from the expanded redlining delegation to the Reserve Banks.	Division of Consumer and Community Affairs
6	Evaluate the Fair Lending Enforcement section’s current staffing structure and approach for reviewing the Reserve Banks’ RAM submissions.	Division of Consumer and Community Affairs

**Finding 3: DCCA Can Clarify and Enhance Its Processes for Internal and External Communications**

<b>Number</b>	<b>Recommendation</b>	<b>Responsible office</b>
7	Develop expectations for communicating with and providing periodic status updates to the Reserve Banks on <ul style="list-style-type: none"> <li>a. UDAP matters, after establishing additional UDAP performance measures or targets pursuant to recommendation 1.</li> <li>b. fair lending matters.</li> </ul>	Division of Consumer and Community Affairs
8	Clarify suggested approaches for coordinating internal communications for UDAP and fair lending reviews that require the input of multiple divisions or sections within DCCA.	Division of Consumer and Community Affairs
9	After establishing the additional UDAP performance measures or targets pursuant to recommendation 1, develop a Systemwide tracking tool to share the status of UDAP matters that outlines the steps in the process, the person(s) responsible for completing the next step(s), and the expected completion date.	Division of Consumer and Community Affairs
10	Identify what information the Reserve Banks can share with supervised institutions and develop formal guidance for communicating with supervised institutions regarding UDAP and fair lending matters.	Division of Consumer and Community Affairs



**Office of Inspector General**

Board of Governors of the Federal Reserve System  
Bureau of Consumer Financial Protection

## MEMORANDUM

**DATE:** October 6, 2021

**TO:** Eric Belsky  
Director, Division of Consumer and Community Affairs  
Board of Governors of the Federal Reserve System

**FROM:** Michael VanHuysen   
Associate Inspector General for Audits and Evaluations

**SUBJECT:** *OIG Report 2021-SR-B-012: The Board Can Improve the Efficiency and Effectiveness of Certain Aspects of Its Consumer Compliance Examination and Enforcement Action Issuance Processes*

We have completed our report on the subject evaluation. We conducted this evaluation to assess the efficiency and effectiveness of the Board of Governors of the Federal Reserve System's and the Federal Reserve Banks' consumer compliance examination and enforcement action issuance processes, including the processes pertaining to unfair or deceptive acts or practices and fair lending matters.

We provided you with a draft of our report for review and comment. In your response, you concur with our recommendations and outline actions that have been or will be taken to address our recommendations. We have included your response as appendix B to our report.

We appreciate the cooperation that we received from the Board and the Reserve Banks during our evaluation. Please contact me if you would like to discuss this report or any related issues.

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# Introduction

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## Objective

Our objective for this evaluation was to assess the efficiency and effectiveness of the Board of Governors of the Federal Reserve System’s and the Federal Reserve Banks’ consumer compliance examination and enforcement action issuance processes, including the processes pertaining to unfair or deceptive acts or practices (UDAP) and fair lending matters. Our scope covered these processes for state member banks with total assets of \$10 billion or less (commonly referred to as *community banks*). Appendix A describes our scope and methodology in greater detail.

## Background

One of the Federal Reserve System’s functions is to promote consumer protection and community development through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and administration of consumer laws and regulations. The System’s consumer-focused supervisory activities seek to promote a fair and transparent financial services marketplace and to ensure that the state member banks within its jurisdiction comply with applicable federal consumer laws and regulations. Specifically, the System evaluates compliance with all federal consumer financial protection laws and regulations for state member banks with total assets of \$10 billion or less.<sup>1</sup>

The Board’s Division of Consumer and Community Affairs (DCCA) is responsible for executing the Board’s consumer protection and community development activities and for identifying and assessing consumer and community development issues so that the Board is aware of emerging opportunities and risks when making policy decisions. DCCA fulfills its supervisory and enforcement responsibilities by supervising institutions and enforcing federal consumer protection laws and regulations that govern how financial institutions conduct their business activities. DCCA’s goals for its supervision and enforcement processes include timely restitution and remediation of deficiencies, tailored and fair supervision and enforcement, and transparent and effective supervision and enforcement.

The Board delegates to each Reserve Bank the authority to supervise certain financial institutions located within the Reserve Bank’s district. Reserve Bank consumer compliance examination staff help execute the Board’s consumer compliance supervision program, and DCCA oversees these delegated supervisory activities. Supervision activities include examinations, which are the System’s primary method of ensuring compliance with federal consumer protection laws and regulations and assessing the adequacy of consumer compliance risk-management systems within supervised institutions.

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<sup>1</sup> With respect to certain UDAP and fair lending laws and regulations, the System has supervisory authority for all state member banks regardless of asset size. The System is also responsible for evaluating compliance with certain other federal consumer financial protection laws not specifically under the Bureau of Consumer Financial Protection’s authority for state member banks with total assets greater than \$10 billion. In addition, the System is responsible for conducting Community Reinvestment Act examinations for state member banks, regardless of asset size, and is the consolidated supervisor for all bank holding companies.

According to DCCA's *Consumer Compliance Handbook*, UDAP and fair lending are two of the most significant consumer compliance risk areas for financial institutions. The handbook states that violations of UDAP and fair lending laws and regulations often cause significant consumer harm and pose legal, financial, and reputational risks to a supervised institution. DCCA's Fair Lending Enforcement and UDAP Enforcement sections work with the Reserve Banks to execute supervisory activities for these two topics. In 2019, the 12 Reserve Banks conducted 343 consumer compliance examinations and DCCA reviewed 96 fair lending matters and 31 potential UDAP violations.

## **Fair Lending Enforcement**

DCCA's Fair Lending Enforcement section, established in November 2007, focuses on ensuring that supervised institutions comply with the following federal fair lending laws and regulations: the Equal Credit Opportunity Act (ECOA), Regulation B, and the Fair Housing Act.<sup>2</sup> Reserve Bank examination teams, through delegated authority from the Board, conduct fair lending reviews regularly within a supervisory cycle, though teams may conduct these reviews outside the typical supervisory cycle if warranted by fair lending risk.

In 2017, DCCA developed and released a fair lending risk assessment tool that facilitates the analysis required by Consumer Affairs Letter 09-6, *Revised FFIEC Fair Lending Examination Procedures and Use of Specialized Examination Techniques*; Consumer Affairs Letter 12-14, *Consolidated Supervision Framework for Large Financial Institutions*; and Consumer Affairs Letter 13-19, *Community Bank Risk-Focused Consumer Compliance Supervision Program*.<sup>3</sup> To evaluate fair lending risk, DCCA and Reserve Bank staff use this tool to analyze a supervised institution's data and other information before starting a consumer compliance examination to determine whether to conduct a low-, moderate-, or high-intensity review.<sup>4</sup> Board and Reserve Bank officials and staff explained that DCCA continues to enhance and update this tool based on feedback from Reserve Bank staff and examiners. One Board interviewee explained that DCCA surveys the Reserve Banks on the tool every year and analyzes the results to assess improvement opportunities or add features.<sup>5</sup> Another Board interviewee noted that the DCCA Fair Lending Enforcement section analyzes the tool's data (such as supervisory outcomes from examinations) annually to determine whether the risk thresholds remain appropriate.

Generally, DCCA has delegated responsibility for conducting low- and moderate-intensity reviews to the Reserve Banks. However, DCCA has historically required the Reserve Banks to refer all high-intensity

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<sup>2</sup> ECOA, which is implemented by the Board's Regulation B (12 C.F.R. 202), prohibits discrimination in any aspect of a credit transaction against persons on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that an applicant's income derives from any public assistance program, or the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act.

<sup>3</sup> The Federal Financial Institutions Examination Council is an interagency body that prescribes uniform principles, standards, and report forms and makes recommendations to promote uniformity in the supervision of financial institutions supervised by the federal financial regulators, of which the Board is one.

<sup>4</sup> The examination intensity for each assessment area or product is calculated based on the risk level for each risk factor. *Low intensity* indicates that no additional analysis is needed. *Moderate intensity* indicates that additional analysis is needed to fully evaluate the fair lending risk but that no additional statistical analysis is needed. *High intensity* indicates that additional analysis is needed and that additional statistical analysis may be needed.

<sup>5</sup> The interviewee stated that DCCA did not administer the survey in 2020 because of the COVID-19 pandemic.

reviews to DCCA.<sup>6</sup> When Reserve Bank examiners find evidence of a potential violation, DCCA's Fair Lending Enforcement section works with the Reserve Bank to provide additional legal and statistical expertise to ensure consistent enforcement of the fair lending laws and regulations.

## ***UDAP Enforcement***

In November 2015, DCCA created the UDAP Enforcement section.<sup>7</sup> Through its UDAP Enforcement section, DCCA ensures that supervised institutions comply with the prohibition against UDAP as set forth in section 5(a) of the Federal Trade Commission Act (FTC Act). If Reserve Bank staff identify a potential UDAP violation through a consumer complaint or consumer compliance examination, the Reserve Bank must refer such a matter to DCCA for review. The UDAP Enforcement section works with the Reserve Banks to provide legal expertise.

## ***The UDAP and Fair Lending Review Processes***

DCCA's UDAP Enforcement and Fair Lending Enforcement sections review the Reserve Banks' referrals of potential UDAP and fair lending violations, respectively, and determine whether to issue a preliminary analysis to notify an institution of a potential violation. Examinations remain open until DCCA staff determine whether a preliminary analysis is needed. Interviewees noted that complex matters may take longer to review. If a preliminary analysis is not needed, DCCA staff inform the Reserve Bank, and the Reserve Bank may close the examination absent any other unresolved issues. If sufficient evidence of a potential violation exists, DCCA and Reserve Bank staff draft a preliminary analysis, which provides the supervised institution (1) an analysis of the potential violation and (2) an opportunity to respond to the findings in writing. According to June 2012 Board guidance, the institution typically has 30 to 45 days to provide a response, but interviewees indicated that institutions often seek and are granted extensions.

After evaluating an institution's response, if DCCA and the Reserve Bank determine that no UDAP or fair lending violation has occurred, DCCA staff inform the Reserve Bank and the Reserve Bank may close the examination. If DCCA and the Reserve Bank conclude that a UDAP violation occurred, DCCA drafts a final analysis. In cases warranting a final analysis, the Board's June 2012 UDAP guidance requires a final analysis to be issued as a precondition to closing the examination. Following the issuance of a final analysis, the Reserve Bank includes an explanation of the violation in the report of examination as well as a general description of the actions required to address the compliance deficiencies and a request for the institution to provide restitution to consumers, if applicable. In accordance with ECOA, the Board refers fair lending matters that may indicate a potential pattern or practice of discrimination to the U.S. Department of Justice (DOJ). The DOJ reviews the referral to determine whether to open an investigation and pursue a public enforcement action or return the matter to the Board for administrative enforcement. In these instances, the Board is responsible for ensuring that the institution takes appropriate corrective action. DCCA and Reserve Bank officials may recommend enforcement actions, as necessary.

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<sup>6</sup> In January 2021, DCCA issued guidance outlining the expanded delegation of certain high-intensity redlining reviews to Reserve Banks.

<sup>7</sup> Before creating the UDAP Enforcement section, DCCA's Fair Lending Enforcement section conducted reviews of potential UDAP violations.

The Board and the Reserve Banks sometimes use Matters Requiring Immediate Attention (MRIAs) and Matters Requiring Attention (MRAs) within an examination report, as well as informal enforcement actions to address UDAP and fair lending issues.<sup>8</sup> In other instances in which DCCA and a Reserve Bank determine that these issues warrant a formal enforcement action, the Board's Legal Division reviews the matter and drafts a formal enforcement action in consultation with DCCA and the Reserve Bank.<sup>9</sup>

## ***System Consumer Compliance Supervision Groups***

The System's Consumer Compliance Management Group (CCMG) and the Fair Lending Community of Practice (Fair Lending COP) support the consumer compliance examination and enforcement action issuance processes. The CCMG is a group composed of Board and Reserve Bank officers responsible for consumer compliance supervision.<sup>10</sup> The CCMG is responsible for promoting consistent and effective implementation of supervisory programs, recommending consumer compliance policy and program enhancements, and supporting the development and implementation of the enhancements. A Reserve Bank official noted that the CCMG is an active and collaborative management group that addresses problems and provides an opportunity to discuss and build consensus for UDAP and fair lending process improvements. The Fair Lending COP consists of members from the Board and each Reserve Bank and holds monthly meetings for Board and Reserve Bank staff interested in fair lending topics to discuss fair lending cases, procedures, and industry trends.<sup>11</sup>

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<sup>8</sup> MRIAs are matters of significant importance and urgency that the System requires banking organizations to address immediately. In the case of consumer compliance, MRIAs include matters that have the potential to cause significant consumer harm. MRAs constitute matters that are important and must be addressed to ensure safe, sound, and compliant operations; however, the threat is less immediate and therefore may be addressed over a reasonable period of time. MRIAs and MRAs remain open until examiners confirm that the banking organization implemented corrective actions.

<sup>9</sup> The System issued two formal enforcement actions to address UDAP violations during our scope period (January 1, 2017, to December 31, 2019) for institutions with total assets of \$10 billion or less.

<sup>10</sup> According to its charter, the CCMG was formed in 2012.

<sup>11</sup> According to a DCCA staff member, DCCA established the Fair Lending COP in 2015.



# Finding 1: DCCA Can Improve the Efficiency and Effectiveness of Its Consumer Compliance Examination and Enforcement Action Issuance Processes for UDAP Matters

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We found that DCCA can improve the efficiency and effectiveness of the UDAP examination and enforcement action issuance processes. Board and Reserve Bank interviewees expressed concerns about the timeliness of DCCA's UDAP review process and the resulting prolonged time frames for issuing consumer compliance examinations. According to interviewees, the extended times to complete UDAP reviews and close examinations reflect ineffective supervisory practices. A June 2012 internal UDAP guidance document states that the objective of the UDAP review process is to reach a fair and accurate conclusion in an efficient manner. Factors that appear to be contributing to the inefficiencies and delays in the UDAP review process as well as limiting the overall effectiveness of the process include (1) the lack of formal performance goals and target time frames throughout the UDAP review process, (2) the lack of criteria and formal guidelines for when the Board must review a potential UDAP matter, (3) insufficient guidance and training provided to Reserve Bank personnel, and (4) potential staffing challenges within the UDAP Enforcement section. The lengthy UDAP review process and resulting prolonged examinations adversely affect consumers, supervised institutions, and Reserve Bank examiners and create reputational risk for the System. Addressing these factors may help improve the efficiency and effectiveness of the consumer compliance examination and enforcement action issuance processes.

## Inefficiencies in DCCA's UDAP Review Process Result in Prolonged Consumer Compliance Examinations

Multiple interviewees expressed concerns about the timeliness of DCCA's UDAP review process and the resulting prolonged time frames for closing consumer compliance examinations. Interviewees noted that when a UDAP matter must be referred to DCCA, examinations take much longer to complete because DCCA does not allow the Reserve Bank to close an examination until DCCA completes a UDAP review. A Board interviewee explained that the Reserve Banks cannot close consumer compliance examinations until the UDAP investigation is complete because a UDAP finding may affect a financial institution's compliance rating and it is difficult for a Reserve Bank to assign an accurate rating without knowing if a UDAP violation occurred. Several interviewees described instances in which these reviews exceeded 1 year. Another Board interviewee noted that DCCA's policy decision to keep examinations open until a UDAP investigation is complete differs from other Board and Reserve Bank examination processes. For example, the same interviewee explained that the Board and the Reserve Banks do not hold a safety and soundness examination open while investigating whether a violation occurred; instead, they complete the investigation outside the examination process.

We analyzed DCCA's Systemwide data on community bank examinations that contained UDAP matters initiated from January 1, 2017, to December 31, 2019. This analysis revealed that DCCA's UDAP review process averaged 276 days and that the average examination time was 370 days.<sup>12</sup> The length of examinations ranged from 57 days to 801 days. In addition, our analysis of DCCA's Systemwide data on community bank examinations closed from January 1, 2017, to December 31, 2019, showed that the average for all consumer compliance examinations, including those with UDAP consultations, was 145 days.

For informational purposes, we sought to understand other federal financial regulatory agencies' practices and time frames for completing examinations containing UDAP or unfair, deceptive, or abusive acts or practices (UDAAP) matters.<sup>13</sup> According to an interviewee from one benchmark agency, that agency shares DCCA's approach of holding a consumer compliance examination open until determining whether a UDAP or UDAAP violation has occurred.<sup>14</sup> However, this interviewee indicated that the agency used guidelines and performance measures that result in shorter reviews and examination times than the Board during our scope period. According to 2017–2019 summary data provided by the interviewee, the benchmark agency completed its examinations containing UDAP or UDAAP matters requiring consultation at a 206-day average versus the Board's 370-day average for the same 3-year period.<sup>15</sup> The guidelines that the benchmark agency adopted that define how staff should address potential UDAP or UDAAP violations and that limit the length of time to complete a UDAP or UDAAP review help to explain the benchmark agency's shorter average examination time frames. Based on our analyses of DCCA's consumer compliance data and our review of sample examinations with UDAP matters, delays in DCCA's and the Reserve Banks' consumer compliance examination and enforcement action issuance processes for potential UDAP violations resulted in prolonged examinations.

According to a June 2012 UDAP internal guidance document, DCCA staff will help facilitate an evaluation of potential UDAP violations by providing legal guidance and quantitative analyses, as appropriate. The guidance states that the objective of the process is to reach a fair and accurate conclusion in an efficient manner. Further, the guidance states that the time frames for evaluating potential UDAP violations will vary depending on the facts and circumstances but that, in the interest of efficiency, communications between Reserve Bank and Board staff should identify action items, responsibilities, and time frames for completion. As outlined in the guidance, Reserve Bank staff may only close a consumer compliance examination after DCCA concludes its analysis regarding any potential UDAP violations.

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<sup>12</sup> We defined the UDAP review process as the number of days between the date the Reserve Bank referred the matter to DCCA and the date DCCA noted as its final findings determination date. We determined the examination time by calculating the average number of days from the examination start date to the examination disposition date.

<sup>13</sup> Section 5 of the FTC Act prohibits a financial institution from engaging in UDAP. In addition, sections 1031 and 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibit an institution from engaging in UDAAP.

<sup>14</sup> To avoid identifying the federal financial regulatory agencies, we use the term *UDAP or UDAAP* for all benchmarks.

<sup>15</sup> We calculated the benchmark agency's average number of days to complete examinations containing UDAP or UDAAP matters requiring consultation from the 2017, 2018, and 2019 averages provided by a benchmark agency interviewee. The examination completion time calculation reflects the beginning of the examination field work to the date the agency sent the report of examination to the financial institution. According to the interviewee, the agency met its target goal for mailing examinations each year within the 3-year period.

## ***DCCA Should Develop Formal Performance Goals or Target Milestones for Both DCCA's and the Reserve Banks' Involvement in the UDAP Examination and Enforcement Action Issuance Processes***

DCCA has not established formal guidelines specifying expected performance goals or targets for completing the UDAP review process. While the June 2012 internal UDAP guidance states that the time frames for evaluating a potential UDAP violation will vary depending on the facts and circumstances, it does not define any performance goals with specific expected timelines for completion. In a June 2018 presentation, DCCA outlined a new pilot program and a general goal to complete its UDAP review process within 1 year for noncomplex matters but did not outline specific timelines for completing its review for complex UDAP matters. The presentation defines noncomplex matters as those matters in which remediation is less than \$500,000, consultation with the Bureau of Consumer Financial Protection or DCCA's Consumer Laws and Regulations section is not required, the institution has not requested an extension or delayed providing necessary information, and the UDAP matter is the only remaining issue keeping the examination open. In the presentation, DCCA also outlined a goal to complete certain expedited matters within 8 months of the examination onsite date. DCCA noted that it would evaluate the program after 1 year; however, interviewees stated that the UDAP Enforcement section never fully executed the pilot program because of staffing limitations.

Board interviewees noted that the UDAP Enforcement section's goal to complete reviews of noncomplex matters within 1 year remains in effect, despite the incomplete pilot program. However, a Board interviewee described varying success in meeting that 1-year performance goal and described the goal as aggressive. Further, several Reserve Bank interviewees were unaware of performance goals, requirements, or initiatives for the UDAP review process.

In addition to lacking general performance goals and target milestones for completing the UDAP review process, DCCA also lacks formal performance goals for completing certain steps within the UDAP review process, such as Reserve Banks referring a matter to DCCA or DCCA initiating and completing a UDAP review. Based on our analysis of DCCA data and interviews with Board and Reserve Bank staff, we learned of delays in various steps within the process. For example,

- Board interviewees noted that the timeliness of the Reserve Banks' referrals to DCCA for potential UDAP matters varied. Based on our analysis of Systemwide DCCA data on community bank examinations initiated from January 1, 2017, to December 31, 2019, that resulted in UDAP reviews, we found that the number of days from the Reserve Bank's examination start date to the date the Reserve Bank referred a potential UDAP violation to DCCA ranged from 9 to 331 days.
- Reserve Bank interviewees noted that their UDAP cases remained in DCCA's queue before DCCA assigned a case to a UDAP Enforcement counsel. For example, one interviewee noted that DCCA did not assign their case to a UDAP counsel until nearly 6 months after the referral. A Board interviewee stated that DCCA sometimes reassigned cases to a different UDAP counsel, which resulted in further delays because the new counsel had to start a new analysis. A Reserve Bank official explained that the UDAP review process is sluggish and unclear and seems to follow different paths and timelines depending on the UDAP assigned attorney. For example, during our analysis of a sampled examination, we identified a 10-month gap between the referral date and

the date DCCA sent follow-up questions to the Reserve Bank for one examination. An interviewee familiar with the matter indicated that insufficient staffing within the UDAP Enforcement section may have caused the delay and that after a long pause, DCCA assigned that case to a newly hired attorney.

In our review of other federal financial regulatory agencies' practices, we found that one agency's guidance outlined decision points in its UDAP or UDAAP review process and corresponding time frames for completion. Another federal financial regulatory agency did not have performance goals for each step within its process but had a firm timeline for completing its overall UDAP or UDAAP review process. An interviewee from this benchmark agency stated that the agency limits its headquarters' time for completing UDAP reviews to a maximum of 90 days. We acknowledge that there are nuances in other federal financial regulatory agencies' structures and approaches for reviewing UDAP or UDAAP matters. We also acknowledge that it may be challenging for DCCA to establish targets addressing all aspects of these processes. However, we believe that DCCA should establish formal performance goals or target milestones for its and the Reserve Banks' involvement in the UDAP review process and that stakeholders will benefit from an assessment by DCCA to identify stages or points in the UDAP review process that lend themselves to establishing interim targets for the expected time or range of time allotted.

## ***DCCA Should Establish Criteria and Formal Guidelines for When It Must Review a Potential UDAP Matter***

DCCA does not have formal guidelines outlining the types of UDAP matters that it will pursue as potential UDAP violations. The June 2012 internal UDAP guidance states that Reserve Bank staff should notify the appropriate Board staff if they identify a potential UDAP violation, but it does not state that DCCA must pursue all potential UDAP violations. According to interviewees, DCCA currently reviews all potential UDAP matters. Certain interviewees stated that DCCA should have criteria (such as the degree of potential consumer harm, priority, complexity, and other possible factors) to determine how the UDAP Enforcement section should use its limited resources to review a potential matter.

Through interviews and our review of documentation provided by other federal financial regulatory agencies, we learned that those agencies consider factors such as pervasiveness, resources, materiality, complexity, novelty, and degree of consumer harm when assessing whether to pursue a potential UDAP or UDAAP violation. The June 2012 internal UDAP guidance does not address these factors. We attributed one federal financial regulatory agency's shorter average examination times to its guidelines that prioritize and define how agency staff should address potential UDAP violations. This agency, which affords more discretion to its regional offices, noted that factors such as the matter's complexity, the need for an enforcement action, its significance, and its novelty trigger the need for a consultation with headquarters.

According to one DCCA interviewee, the division's approach commits resources that could be better used to address matters having a greater effect on consumers. A 2018 UDAP and Fair Lending Process Enhancements presentation noted that the majority of UDAP matters are resolved through nonpublic actions, indicating lesser severity. An interviewee noted that knowing how and when to calibrate the significance and complexity of matters is important but that DCCA seemingly categorizes all UDAP concerns as the same, regardless of the significance of the matter. The interviewee indicated that the lack of calibration is the primary factor for UDAP delays.

In our analysis of sample examinations with potential UDAP matters, we noted that one of DCCA's reviews stemmed from a Reserve Bank referral pertaining to an institution's product enrollment and billing approach. In the referral, Reserve Bank staff concluded that the matter did not rise to the level of a UDAP violation and provided an analysis indicating that the matter resulted in recurring erroneous charges to one consumer totaling \$18.00. In the Reserve Bank's referral, a Reserve Bank official noted that the financial institution implemented a fairly robust monitoring program to prevent UDAP. DCCA prepared its initial internal analysis of the matter 56 days following the referral. In its internal analysis, DCCA recommended citing the practice in the examination report and not pursuing the formal UDAP process; however, DCCA and Reserve Bank staff continued to discuss the matter for several months. During this time, Reserve Bank staff discussed the matter with the financial institution. The Reserve Bank did not issue the report of examination until 364 days after the start of the onsite examination; the report did not cite a UDAP violation.

A Reserve Bank official stated that if DCCA limited its focus to high-priority cases, Reserve Banks could resolve lower-priority matters more timely. In a 2018 internal memorandum, DCCA acknowledged pressure from Reserve Banks to delegate certain UDAP matters to Reserve Bank personnel and the apparent tradeoffs with its strategic choice to review all UDAP matters. In the memorandum, DCCA stated that such delegation would make it impossible to ensure rigorous and consistent enforcement and acknowledged that the UDAP review process can be both unwieldy and inefficient. Instead of delegating the review of less-complex UDAP matters to the Reserve Banks, DCCA attempted to improve timeliness by delegating authority to the associate director and senior associate director who oversee the UDAP Enforcement section. However, one Board interviewee stated that in practice, DCCA is not using the delegation to its full extent and noted that not every violation needs to go to the DCCA division director for approval. According to one Reserve Bank interviewee, the System's culture is to be precise and perfect.

## ***DCCA Should Provide Supplemental Guidance and Training to Reserve Banks to Address Program Changes and Emerging Risks***

Reserve Bank interviewees noted that it is not always clear what information the UDAP Enforcement section needs to review a potential UDAP matter. DCCA interviewees noted that inconsistent fact gathering and analysis standards throughout the System affect the quality of Reserve Bank submissions, which can cause delays within the UDAP review process. Interviewees indicated that DCCA staff often request additional information from Reserve Bank staff who then must request additional information from the institution, which causes delays. Board and Reserve Bank interviewees noted that updated UDAP guidance and training would be beneficial and help DCCA to expedite its reviews.

The June 2012 internal UDAP guidance is the Board's most current formal guidance document addressing the UDAP review process. This guidance, however, predates the establishment of the UDAP Enforcement section and does not fully reflect the section's current structure or process. Interviewees noted that an update to the June 2012 internal UDAP guidance could provide clear guidance on the current UDAP examination and enforcement action issuance processes. In addition, the June 2012 internal UDAP guidance provides only general guidance on the information Reserve Bank personnel should collect. DCCA interviewees indicated that Reserve Banks sometimes provided DCCA with information that was

inconsistent, unclear, or insufficient to conduct the UDAP review process. Interviewees stated that the Reserve Banks have different standards for the required analysis and fact gathering before submitting referrals to DCCA. For example, one Reserve Bank contributed to a delay in closing an examination by spending nearly 6 months conducting its analysis before referring that UDAP matter to DCCA.

Additionally, interviewees noted the nuances and complexity of UDAP violations and expressed the need for additional Board guidance, such as case studies, training, templates, or job aids. One interviewee stated that case studies allow examiners to understand what might be a UDAP risk at other institutions and enable them to better assess when institutions they examine are engaging in similar practices. One Reserve Bank official stated that they would encourage DCCA to conduct more training and outreach, as well as to provide case studies, to help Reserve Bank staff analyze UDAP and fair lending issues. This official stated that case studies could help the Reserve Banks to ensure that the submissions to the Board are thorough, which could help DCCA expedite its reviews. One Reserve Bank interviewee stated that templates help raise awareness of requirements and supporting documentation needed for DCCA's analysis. A Board interviewee acknowledged that the agency has not developed a UDAP training packet that would help to promote a consistent high-level result.

DCCA and Reserve Bank interviewees said that DCCA has provided UDAP training in the past. According to a Reserve Bank official, there is a continued need for training, guidance, and a real-time approach to find what is working and the best way to resolve challenges. A Reserve Bank interviewee stated that the Board provided training on UDAP 3 or 4 years ago but expressed that the training would benefit from an update. Another Reserve Bank interviewee noted that UDAP training would help examiners to identify potential UDAP issues.

## ***DCCA Should Assess the UDAP Enforcement Section's Staff Allocation and Roles***

Several interviewees indicated that the UDAP Enforcement section was understaffed until recently and could not handle the volume of cases referred by the Reserve Banks. While interviewees noted that the UDAP Enforcement section recently hired additional staff, some felt that the UDAP review process could be more efficient by adding a nonattorney analyst who could track and monitor UDAP reviews. A Board official shared this viewpoint and stated that staffing within the UDAP Enforcement section is tight, especially if there is a desire to review cases more quickly. The Board official added that the UDAP Enforcement section is fully staffed from a budgetary perspective, but the official noted the potential need for additional staff. Another Board interviewee attributed the challenges in meeting the 12-month goal for noncomplex matters largely to resource constraints affecting the UDAP Enforcement section since its formation in 2015. We believe that DCCA can assess the UDAP Enforcement section's staffing allocations to determine whether the current level of staffing is sufficient to efficiently and effectively conduct UDAP reviews.

## ***Prolonged Examinations May Negatively Affect Consumers, Supervised Institutions, and Reserve Bank Examiners and May Present Increased Reputational Risk for the System***

Several interviewees expressed concerns about the adverse effect these prolonged examinations have on consumers, supervised institutions, and Reserve Bank examiners. Further, interviewees noted that the delays and prolonged examinations create an increased reputational risk for the System. According to interviewees, the extended times to complete UDAP reviews and close examinations detract from the effectiveness of supervisory practices. For example, interviewees noted that the extended UDAP review process limits an institution's ability to take prompt action to remediate the causes of potential UDAP violations and prevent additional consumer harm. A Reserve Bank official noted that the priority in the UDAP review process should be addressing consumer harm but that the extended UDAP review process prevents institutions from paying restitution to affected consumers timely. An interviewee noted multiple instances in which institutions worked promptly to resolve matters by developing a potential remedy for consumers but could not implement the corrective action because DCCA and Reserve Banks were not finished with their analysis and the resulting outcome may have required a different action.

Board and Reserve Bank interviewees also noted that supervised institutions generally want to resolve outstanding matters promptly so that they can proceed with the institutions' business. In a 2019 presentation, DCCA noted that if a financial institution requests approval for early remediation, the Reserve Bank must inform the institution in writing that DCCA generally supports a financial institution's efforts to reimburse consumers and take corrective action to prevent further harm but may determine that those efforts are not adequate and that a different remediation method and process is appropriate. The 2019 presentation also advised Reserve Banks to refrain from approving, endorsing, or rejecting any particular remediation plan while a UDAP matter is pending. A 2013 guidance document states that a state member bank in less-than-satisfactory condition, or which has a less-than-satisfactory record of consumer compliance or performance under the Community Reinvestment Act, generally should not pursue expansionary proposals and should focus on remediating identified supervisory issues. Board and Reserve Bank interviewees noted that an open UDAP review may prevent institutions from pursuing certain business activities, such as conducting mergers and acquisitions or opening new branches. Interviewees noted that these delays can have an adverse financial effect on institutions that rely on mergers and acquisitions as part of their business strategies.

Prolonged examinations also increase the supervision burden on institutions. Some interviewees noted that because of the extended length of the UDAP review process, their Reserve Bank was starting a new examination at an institution soon after concluding a preceding examination, requiring significant resources from the institution to provide necessary documentation and information to regulators.

Moreover, according to interviewees, prolonged examinations require examiners to balance new examination work while recalling details, fielding questions, and responding to information requests on open UDAP reviews. Interviewees also said prolonged examinations put Reserve Bank staff in a difficult position, as they are interacting with an institution's management, who may express frustration or complain about lengthy examinations and the UDAP review process. Interviewees indicated that these factors can demoralize and frustrate examiners.

Several interviewees also expressed concern that the lengthiness of the UDAP review process may create reputational risk for the System. Specifically, one Reserve Bank official stated that keeping an examination open for a long period puts the Reserve Banks in a difficult position and could have an adverse reputational effect on the Board and the Reserve Banks. Another Reserve Bank official noted that the amount of time the Board needs to resolve cases is harmful to the System's reputation and that the Board should have processes that are efficient and transparent. Additionally, interviewees said that the prolonged times to complete UDAP reviews may hinder the Board's and the Reserve Banks' efforts to protect consumers through supervision.

## Conclusion

We believe that DCCA can update its existing guidance and develop new guidance to include performance measures or targets and criteria for pursuing UDAP matters. DCCA can also provide training and other job aids to Reserve Bank staff. In addition, we believe that DCCA can assess the UDAP Enforcement section's staffing and roles and responsibilities. Addressing these matters may help improve the efficiency and effectiveness of the consumer compliance examination and enforcement action issuance processes.

## Recommendations

We recommend that the director of DCCA

1. Revise the approach for conducting UDAP reviews by
  - a. reassessing the current approach for conducting UDAP reviews.
  - b. establishing additional formal performance measures or targets for completing steps within the UDAP review process.
  - c. defining criteria for determining when DCCA must review a potential UDAP matter.
  - d. issuing guidance consistent with the results of that assessment.
2. Update the June 2012 internal UDAP guidance to reflect program changes that have occurred since establishing the UDAP Enforcement section.
3. Develop templates and other training materials that include case studies on UDAP matters for the Reserve Banks to distribute to their UDAP specialists and consumer compliance examiners. After developing the templates and training materials, DCCA should
  - a. define the frequency for conducting periodic training.
  - b. define a plan for providing case studies on a periodic basis to highlight emerging risks as well as frequent or common cases.
4. Assess the current level of staffing within the UDAP Enforcement section to determine whether staffing is appropriate to efficiently and effectively conduct UDAP reviews. As part of this assessment, consider the effect of prospective changes regarding how DCCA selects and prioritizes UDAP reviews.

## Management Response

In its response to our draft report, DCCA concurs with our recommendations. DCCA states that it is developing action plans to address the recommendations and meet the commitments in its management response.

Specifically, in response to recommendation 1, DCCA states that by the end of the fourth quarter of 2022, DCCA will reassess its approach for conducting UDAP reviews. DCCA will also establish additional formal performance measures or targets for completing steps in the UDAP review process. DCCA plans to define criteria for determining which potential UDAP matters Reserve Banks will send to DCCA for review. Further, DCCA states that it will issue guidance consistent with the results of its assessment of the System's approach to conducting UDAP reviews, establish additional performance measures and targets, and identify specific criteria for determining when DCCA must review a potential UDAP matter.

In response to recommendation 2, DCCA states that by the end of the fourth quarter of 2022, it will issue an update to its June 2012 internal UDAP guidance to reflect changes made to the UDAP program since establishing the UDAP Enforcement section.

In response to recommendation 3, DCCA states that by the end of the fourth quarter of 2022, it will develop templates and other training materials that include case studies on UDAP matters for the Reserve Banks to distribute to their UDAP specialists and consumer compliance examiners. DCCA will define the frequency for conducting periodic training for the Reserve Banks and a plan for providing updated case studies on a periodic basis to highlight emerging risks as well as frequent or common cases.

In response to recommendation 4, DCCA states that by the end of the fourth quarter of 2021, DCCA will assess the current level of staffing within the UDAP Enforcement section to determine whether staffing is appropriate in terms of staff position type and number to efficiently and effectively conduct UDAP reviews. DCCA states that its staffing assessment will consider the effect of prospective changes regarding how DCCA selects and prioritizes UDAP reviews.

## OIG Comment

The actions described by DCCA appear to be responsive to our recommendations. We will follow up to ensure that the recommendations are fully addressed.



## Finding 2: DCCA Can Improve the Efficiency and Effectiveness of Its Consumer Compliance Examination and Enforcement Action Issuance Processes for Fair Lending Matters

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We found that DCCA can improve the efficiency and effectiveness of the fair lending examination and enforcement action issuance processes. Many interviewees described concerns with DCCA's fair lending review process and noted this review process results in prolonged consumer compliance examinations. In our opinion, these lengthy review processes result in prolonged examinations that detract from the overall effectiveness of the program. According to a June 2012 internal fair lending guidance document, the objective of DCCA's fair lending review process is to reach a fair and accurate conclusion in an efficient manner. We attribute the issues surrounding the efficiency and effectiveness of this process to (1) the historical lack of sufficient performance measures and targets for the steps within the fair lending examination and enforcement action issuance processes, (2) the need for additional Reserve Bank staff and examiner training, and (3) the need to assess the current staffing structure and approach within the Fair Lending Enforcement section. We acknowledge that DCCA has recently made efforts to improve the timeliness of the fair lending review process, such as establishing new performance measures and targets and refining the criteria for delegating certain high-intensity fair lending reviews to the Reserve Banks. To effectively support these process changes, we believe that DCCA can develop additional training to acclimate Reserve Bank staff and examiners to newly delegated roles and responsibilities. We also believe that DCCA should assess its current fair lending staffing structure and approach.

### Inefficiencies in DCCA's Fair Lending Review Process Reduced the Effectiveness of Its Supervisory Process

According to a July 2020 presentation, 36 of 343 consumer affairs examinations in 2019 had a high-risk redlining matter requiring DCCA consultation.<sup>16</sup> Multiple interviewees expressed concerns regarding the timeliness of DCCA's fair lending review process. In addition, Reserve Bank interviewees noted that delays in DCCA's review process prevent the Reserve Banks from closing examinations in a timely manner, which we believe reduces the effectiveness of the supervisory process. Similar to the UDAP process, the Reserve Banks are unable to close an examination while DCCA's fair lending review is ongoing.

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<sup>16</sup> *Redlining* is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the applicant resides or will reside or in which the residential property to be mortgaged is located.

According to June 2012 internal fair lending guidance, DCCA's Fair Lending Enforcement section helps facilitate the evaluation of potential fair lending violations by providing legal guidance and quantitative analyses, as appropriate. The guidance states that the objective of this process is to reach a fair and accurate conclusion in an efficient manner. Further, the guidance states that the time frames for evaluating potential fair lending violations will vary depending on the facts and circumstances but that, in the interest of efficiency, communications between Reserve Bank and Board staff should identify action items, responsibilities, and time frames for completion.

We attribute the efficiency and effectiveness issues that we noted to three factors. The first factor is the historical lack of sufficient performance measures and targets for the steps within the fair lending examination and enforcement action issuance processes. We acknowledge that DCCA has recently made efforts to improve the timeliness of the fair lending review process by establishing new performance measures and targets as well as refining the criteria for delegating certain high-intensity fair lending reviews to the Reserve Banks. The second factor is the need for additional training for Reserve Bank staff executing high-intensity fair lending reviews. We believe that DCCA can develop additional training to acclimate Reserve Bank staff and examiners to newly delegated roles and responsibilities. The third factor is the need to assess the current staffing structure and approach within the Fair Lending Enforcement section. We believe that DCCA may benefit from assessing its staffing structure and approach to reviewing Reserve Banks' redlining submissions.

### ***DCCA Developed New Timing Expectations and Expanded the Delegation of Certain Fair Lending Reviews***

We learned that the historical lack of sufficient performance measures and targets for the steps within these processes may have affected the efficiency and effectiveness of the fair lending examination and enforcement action issuance processes. In 2015, DCCA and the Reserve Banks established a 20-week goal from the start of an examination to determine whether a potential fair lending violation warranted a preliminary analysis. However, this 20-week goal did not include additional detailed interim goals and targets for specific steps within the examination process or timing expectations within the 20 weeks specific to the Reserve Banks. Further, the 20-week goal did not include the Reserve Banks' preexamination scoping period, the steps that follow a decision to pursue a preliminary analysis, or the steps to finalize and close an examination.

According to an interviewee from another federal financial regulatory agency, that agency's headquarters staff aim to complete informal fair lending consultations within 14 to 30 days and formal fair lending consultations within 30 to 60 days. In addition, the interviewee noted that this federal financial regulatory agency sends a preliminary letter to the financial institution so that it may provide the agency with additional information pertaining to the fair lending matter. The agency then makes its final determination and sends the financial institution a final letter indicating that a violation of the fair lending laws or regulations occurred. An interviewee from the agency stated that staff rarely take longer than 90 days for formal consultations. The interviewee also stated that formal consultations occur when the agency's regional office decides to notify a financial institution of a preliminary determination that the financial institution has engaged in a pattern or practice that would indicate a potential fair lending violation and potentially result in a referral to the DOJ.

In a June 2018 presentation to senior System officials, DCCA reported that it met or was meeting its 20-week goal for more than 90 percent of the 72 matters referred from October 2017 through June 2018. However, despite DCCA reporting that it met the 20-week goal for more than 90 percent of the referred matters, Reserve Bank interviewees expressed their dissatisfaction with the wait times required for DCCA's Fair Lending Enforcement section to make a preliminary analysis determination. A Reserve Bank interviewee noted that 20 weeks is a long time to hold an examination open at a small community bank. Board interviewees described various factors that could affect the time needed to reach a preliminary analysis determination, including the type and complexity of a fair lending matter and receiving information about a potential violation from a Reserve Bank toward the end of the 20-week period. An interviewee indicated that fair lending reviews involving potential pricing or underwriting violations tend to move efficiently but that complex redlining reviews and reviews for matters that may warrant a preliminary analysis take longer.<sup>17</sup> Although we understand that drafting and completing a preliminary analysis was not included in the 20-week timeline goal, according to a Board interviewee, it was almost impossible to meet the 20-week timeline goal when a preliminary analysis was warranted. Another Board interviewee explained that the fair lending review process usually extends past the 20-week timeline goal when a process includes a preliminary analysis because of back-and-forth discussions between the Reserve Bank and DCCA.

Similar to the UDAP review process previously discussed, delays in closing examinations in a timely manner may adversely affect examiner efficiency as well as supervised institutions and may pose a reputational risk for the System. One interviewee indicated that when a review of a fair lending matter takes several months to complete, it can be very difficult for examiners to complete that examination work because they have often transitioned to new examinations. In addition, another interviewee noted that open fair lending matters present a timeliness issue and that institutions with an open review are unable to engage in strategic corporate activities like mergers or acquisitions.

In January 2021, DCCA issued new guidance that expanded the criteria for delegating certain fair lending reviews pertaining to redlining to the Reserve Banks. According to this guidance, the Reserve Banks no longer must consult with the Board's Fair Lending Enforcement section on supervisory analyses of certain high-risk assessment areas before examination closure.<sup>18</sup> The January 2021 internal guidance also states that for all nondelegated high-risk redlining reviews, the Board's Fair Lending Enforcement section must continue to review and approve the Reserve Banks' redlining analysis memorandums (RAMs) before examination closure. Examiners draft a RAM to summarize their assessment of an institution's redlining risk and recommend a potential supervisory action. In addition, the internal guidance states that this expanded delegation does not alter the Fair Lending Enforcement section's role in assessing a preliminary finding of discrimination, reviewing potential violations of the law, reviewing preliminary findings of discrimination, or preparing referrals to the DOJ.

In January 2021, DCCA also implemented new timing expectations for both the Reserve Banks and DCCA that address some fair lending matters, specifically certain high-risk redlining matters. The new timing expectations reduce the goal to complete the review of redlining matters to 15 weeks and establish

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<sup>17</sup> A *pricing violation* is a form of illegal treatment in which a lender prices credit higher on a prohibited basis. An *underwriting violation* is a form of illegal treatment in which a lender denies or provides unequal loan terms on a prohibited basis.

<sup>18</sup> The Reserve Banks are not required to consult with DCCA's Fair Lending Enforcement section when there is insufficient basis for a high risk of a potential fair lending violation, such as for low- or moderate-risk assessment areas.

interim timing goals for the Reserve Banks and DCCA.<sup>19</sup> These new timing goals require the Reserve Banks to submit potential redlining violation referrals to DCCA within 42 to 56 days from the examination open date. Further, the timing goals require DCCA to complete its review and determine whether to issue a preliminary analysis within 35 to 49 days following receipt of the Reserve Bank's referral. These new timing goals vary based on the number of high-risk assessment areas at a supervised institution.<sup>20</sup> According to a DCCA interviewee, the 20-week goal for the review of other fair lending matters, such as pricing and underwriting, remains in effect; the interviewee noted that reviews for such matters tend to be completed efficiently. Another interviewee stated that underwriting and pricing reviews are often completed before the start of an examination. We noted in one sample review that DCCA completed an underwriting and pricing review 24 days before the start of an examination. We believe that these recently established timing expectations and expanded delegation may help enhance the efficiency and effectiveness of certain fair lending review processes. However, we believe that in light of these changes, the Board should develop additional training to help support this transition.

## ***DCCA Can Develop Additional Training to Acclimate Reserve Bank Staff and Examiners to Newly Delegated Roles and Responsibilities***

Another factor that may affect the efficiency and effectiveness of the fair lending examination and enforcement action issuance processes is the need for additional training for Reserve Bank staff and examiners on certain fair lending matters. While interviewees noted that there are fair lending training materials and other channels available to the Reserve Banks, Reserve Bank interviewees expressed that additional training materials that clarify DCCA's expectations for RAMs would be helpful. One Reserve Bank official indicated that DCCA's request for more information from Reserve Bank staff after they have submitted referrals to DCCA sometimes creates additional delays in the examination process. Specifically, we learned that the redlining review process can be lengthy and that DCCA staff often need to edit the Reserve Banks' RAMs, which can contribute to additional delays. As previously noted, examiners draft a RAM to summarize their assessment of an institution's redlining risk and recommend potential supervisory action. Board interviewees noted that the Reserve Banks' RAM submissions varied in quality and some required material changes. In addition, DCCA provided us with documentation outlining its assessment of all the high-risk redlining matters that DCCA reviewed in 2019 through the first quarter of 2020. In this assessment, DCCA noted that during its review of high-risk redlining matters, it found that the RAMs often required material changes or lacked support for the Reserve Banks' recommendations and that DCCA's review resulted in changes to the Reserve Banks' recommended risk rating or supervisory outcome.

Board interviewees indicated that over the past several years, DCCA developed communication channels, a fair lending risk assessment tool, and fair lending training materials to support the Reserve Banks. For

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<sup>19</sup> These new timing expectations also require the Reserve Banks to issue the report of examination within 70 days from the preliminary analysis decision.

<sup>20</sup> For nondelegated high-risk redlining matters with one high-risk assessment area, the Reserve Banks must submit their RAMs to DCCA within 42 days of the examination open date and DCCA must complete its review within 35 days of receiving the RAM. For nondelegated high-risk redlining matters with two or more high-risk assessment areas, the Reserve Banks must submit their RAMs to DCCA within 56 days of the examination open date and DCCA must complete its review within 49 days of receiving the RAM.

example, in 2015, DCCA established the Fair Lending COP that holds monthly meetings for Board and Reserve Bank staff interested in fair lending topics to discuss fair lending cases, procedures, and industry trends. Several DCCA and Reserve Bank interviewees expressed that these monthly calls have been beneficial. For example, a Board interviewee explained that the Fair Lending COP discussions help Reserve Bank staff understand how other Reserve Banks identify and manage fair lending cases. In addition, DCCA developed and released a fair lending risk assessment tool in 2017 to facilitate a consistent assessment of fair lending risk and potential fair lending violations. Several Board and Reserve Bank interviewees indicated that the fair lending risk assessment tool that DCCA developed has improved consistency in assessing fair lending risk among the Reserve Banks, streamlined the fair lending scoping portion of consumer compliance examinations, and provided clear expectations for how examiners should assess fair lending risk. We learned that DCCA's Fair Lending Enforcement section staff conducted onsite fair lending training activities at a few Reserve Banks in 2019 and 2020 but had to pause those training activities because of the COVID-19 pandemic; staff are uncertain when that training may resume. Additionally, DCCA's Fair Lending Enforcement section staff developed and distributed a RAM template and a sample RAM for the Reserve Banks to begin using in January 2021. DCCA also recently developed guidance that outlines the roles and responsibilities for Reserve Bank personnel completing the delegated reviews.

While we acknowledge that DCCA has made efforts to address certain training needs, many of these efforts were made before delegating certain high-intensity fair lending reviews to the Reserve Banks, and we believe that DCCA should develop and conduct additional formal training given this expanded delegation and other recently implemented guidance. Further, when conducting monitoring and follow-up reviews concerning this expanded delegation, DCCA may identify areas of focus for further training.

## ***DCCA Can Assess the Current Staffing Structure and Approach for Its Fair Lending Review Process***

We learned that another factor that may affect the efficiency and effectiveness of the fair lending examination and enforcement action issuance processes is the current staffing structure and approach within DCCA's Fair Lending Enforcement section. Several Reserve Bank interviewees indicated that DCCA's Fair Lending Enforcement section has only one analyst conducting the first-level review of the Reserve Banks' RAMs. As noted previously, a total of 36 of 343 consumer affairs examinations in 2019 had a high-risk redlining matter requiring DCCA consultation. Several Reserve Bank interviewees expressed that the volume of work to conduct the analysis for all 12 Reserve Banks was too much for one individual. Certain Board interviewees noted, however, that there are also two attorneys within the section who typically perform the second-level review of the RAMs. One Board interviewee further explained that these two attorneys sometimes complete the first-level review when needed. One Board interviewee explained that this review process ensures that the Fair Lending Enforcement section agrees with the analysis of the Reserve Bank's RAM before determining the appropriate supervisory outcome. Board interviewees expressed a potential need for additional staffing; however, a DCCA official indicated that DCCA has previously requested additional resources to help with redlining analyses but did not receive additional resources because of budgetary limitations.

Although the newly expanded delegations to the Reserve Banks may result in fewer RAMs requiring DCCA's review, it is not clear if the division will continue to rely on one individual to conduct the first-level review of RAMs submitted to DCCA. The Board has also not established a formal approach for the

circumstances in which Fair Lending Enforcement counsel will assist in the first-level review of potential redlining violations. Given the Reserve Banks' newly delegated responsibilities, Reserve Banks may continue to raise questions to DCCA and seek support in completing the analyses. For example, one Reserve Bank official noted that their respective Reserve Bank colleagues will need to continue consulting with DCCA's Fair Lending Enforcement section to ensure that DCCA is comfortable with the Reserve Bank's conclusion. Further, the January 2021 internal guidance notes that while certain matters may not require consultation with the Board's Fair Lending Enforcement section before examination closure, examiners may still contact the Fair Lending Enforcement section at any time for consultation or assistance on any issue. In addition, DCCA plans to retrospectively monitor the Reserve Banks' execution of these newly delegated high-risk redlining matters.

While we acknowledge there is still some uncertainty given the recent changes to the fair lending process, we believe that DCCA may benefit from assessing its staffing structure and approach to reviewing Reserve Banks' RAM submissions. Such an assessment could help DCCA to determine whether the Fair Lending Enforcement section should establish a formal approach for providing support for the Reserve Banks' redlining analyses and whether the section needs additional staff, such as another analyst, to help complete nondelegated high-intensity reviews and support potential monitoring efforts.

## Conclusion

Prolonged consumer compliance examinations may result in delayed remediation to consumers, increased burden to institutions, challenges for examiners, and increased reputational risk to the System. We believe that by addressing the factors outlined above, DCCA can improve the efficiency and effectiveness of the processes for fair lending matters and mitigate the risks. DCCA should develop additional training to acclimate Reserve Bank staff and examiners to newly delegated roles and responsibilities. We also believe that DCCA should assess its current fair lending staffing structure and approach.

## Recommendations

We recommend that the director of DCCA

5. Develop additional training to acclimate Reserve Bank staff and examiners to new roles and responsibilities resulting from the expanded redlining delegation to the Reserve Banks.
6. Evaluate the Fair Lending Enforcement section's current staffing structure and approach for reviewing the Reserve Banks' RAM submissions.

## Management Response

In its response to our draft report, DCCA concurs with our recommendations. Specifically, in response to recommendation 5, DCCA states that by the end of the second quarter of 2022, it will provide additional training to Reserve Bank staff and examiners on the expanded redlining delegation and monitoring practices for the expanded delegation. DCCA further notes that it will continue to develop and update existing examiner job aids to assist examiners in conducting high-risk redlining reviews and will provide training on any updated job aids.

In response to recommendation 6, DCCA states that it is in the process of reviewing the Fair Lending Enforcement section's current staffing structure in light of the expanded redlining delegation and monitoring practices for the expanded delegation, cross-training existing staff to provide additional support, and updating existing staff's priorities to ensure that all RAMs are reviewed under established timelines. Additionally, DCCA states that it will evaluate the Fair Lending Enforcement section's approach for reviewing the Reserve Banks' RAMs by the end of the first quarter of 2022.

## **OIG Comment**

The actions described by DCCA appear to be responsive to our recommendations. We will follow up to ensure that the recommendations are fully addressed.



## Finding 3: DCCA Can Clarify and Enhance Its Processes for Internal and External Communications

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Interviewees indicated that internal Board communications for UDAP and fair lending matters could be improved and described a lack of transparency into DCCA’s processes for UDAP and fair lending reviews. Many Reserve Bank interviewees expressed that it would be beneficial for DCCA to clarify expectations for communicating and sharing information for ongoing UDAP or fair lending matters with supervised institutions. The Board’s June 2012 internal guidance outlines the communication and collaboration framework between Reserve Bank and Board staff when evaluating potential UDAP and fair lending violations and indicates that communications should identify action items, responsibilities, and time frames for completion. We attribute many of the communication challenges to DCCA not establishing clear expectations for effective internal and external communications. DCCA has not fully implemented or shared a Systemwide tracking tool or an internal dashboard to share the status of UDAP matters. We believe that formal guidance that defines expectations for communications, including formal expectations for providing status updates, may help enhance transparency into the supervisory processes and help Reserve Bank staff to better manage relationships with supervised institutions.

### DCCA Can Establish Expectations for Internal Communications and Communications Between the Board and the Reserve Banks

Reserve Bank interviewees indicated that DCCA’s communications related to UDAP and fair lending matters can at times be inconsistent, infrequent, and lacking in sufficient detail. Multiple Reserve Bank interviewees indicated a lack of transparency about the status of examination and enforcement action–related matters undergoing DCCA review and noted that Reserve Bank staff often do not know the status or expected turnaround time for a particular examination matter. Further, several Reserve Bank interviewees described DCCA’s internal review process as a “black box” or “opaque.” Several Reserve Bank officials explained that DCCA does not proactively provide status updates on examination and enforcement action matters and that Reserve Bank staff must initiate contact with DCCA to obtain this information.

Interviewees indicated that some Reserve Banks have established specialist roles that focus on UDAP or fair lending matters to assist examiners throughout the consumer compliance examination and enforcement action issuance processes. According to interviewees, these specialists often serve as a central point of contact for communicating with the Board. Interviewees also noted that the Reserve Banks and DCCA hold monthly meetings to discuss UDAP and fair lending matters. While interviewees noted the benefits of these communication channels, many Reserve Bank interviewees indicated a need for DCCA to increase proactive status updates. In addition, several Reserve Bank interviewees noted that responses to the Reserve Bank’s status inquiries often lack sufficient detail.

Interviewees indicated a need for improved internal communications among the various groups or divisions at the Board and with the Reserve Banks regarding consumer compliance matters. While most potential fair lending or UDAP violations require Reserve Bank staff to communicate with the relevant DCCA Enforcement section, some potential violations may require Reserve Bank staff to coordinate with different Board groups. In these cases, Reserve Bank interviewees indicated that communicating with different Board groups makes the collaboration process more difficult. For example,

- Board and Reserve Bank interviewees noted that examinations involving both UDAP and fair lending matters may require Reserve Bank staff to communicate with DCCA's UDAP Enforcement and Fair Lending Enforcement sections through separate communication channels. A Reserve Bank interviewee explained that there does not seem to be much interaction between the two sections regarding these examinations, so it falls upon the Reserve Banks to update DCCA on the status of the respective matters.
- In addition to potential communication challenges between the DCCA's Fair Lending Enforcement and UDAP Enforcement sections, another Reserve Bank interviewee indicated that those sections and DCCA's Oversight section may not coordinate well. A Reserve Bank official noted that Reserve Bank staff typically work with DCCA's Oversight section on most consumer compliance matters, with the exception of UDAP and fair lending matters. The official added that it appears the communication between the Fair Lending Enforcement and UDAP Enforcement sections and the Oversight section within DCCA is not as strong as it could be.
- Further, Board interviewees noted that communications between DCCA and the Board's Legal Division for UDAP matters seem ineffective. A Board interviewee said that despite holding weekly meetings with DCCA staff, the Board's Legal Division was often not aware of the need for a formal enforcement action until DCCA requested the action. Further, Board officials expressed the need for DCCA to communicate when an enforcement action may be warranted with the Board's Legal Division earlier in the UDAP review process.

The Board's June 2012 internal guidance describes the framework for communication and collaboration between Reserve Bank and Board staff when evaluating potential UDAP and fair lending violations. The guidance indicates that communications between the Reserve Bank and Board staff should identify action items, responsibilities, and time frames for completion.

Based on our interviews and review of documentation, we attribute many of these communication challenges to DCCA not establishing expectations for internal communications, such as expectations for providing status updates to Reserve Banks and communicating and coordinating with other groups or divisions within the Board. We also noted that DCCA had not fully implemented or shared a Systemwide tracking tool or an internal dashboard for Reserve Bank staff to view the status of UDAP matters under review. Multiple Reserve Bank interviewees expressed that it would be beneficial to have a Systemwide tracking application for this purpose. DCCA's Fair Lending Enforcement section recently implemented an examination timing tracker, the Fair Lending Order of Work (FLOW), for examinations starting after January 26, 2021. Reserve Banks must enter all high-intensity redlining matters into FLOW. In addition, DCCA must enter preliminary analysis determination dates and fair lending matter closure dates into FLOW. With respect to UDAP matters, interviewees indicated that UDAP attorneys manually track their own cases. A Board interviewee noted that the UDAP enforcement section is working with DCCA and the Board's Division of Information Technology to develop an advanced UDAP tracking tool for internal Board

use. However, the interviewee stated they were not aware of any plans to develop a Systemwide UDAP tracking tool.

## **DCCA Can Clarify and Enhance Processes for Communicating With External Stakeholders**

Reserve Bank interviewees also expressed that it would be beneficial for DCCA to clarify expectations for communicating and sharing information for ongoing fair lending or UDAP matters with supervised institutions. Reserve Bank staff play a critical role in managing the relationship with supervised institutions. Interviewees from several Reserve Banks noted that their lack of clarity regarding the status of matters under review by DCCA can put them in a difficult position when communicating with supervised institutions. Interviewees explained that Reserve Bank staff often receive questions from institutions regarding the status of examinations but do not always have the requisite information to provide direct, timely answers. Reserve Bank interviewees said that it is important for the person communicating with an institution to have as much information and insight as possible to be able to relay that information. Further, Reserve Bank interviewees noted that the lack of transparency into DCCA's prioritization of UDAP matters and the inability to track DCCA's progress on examination matters resulted in Reserve Bank management lacking the information necessary to effectively schedule supervision employees on future examination activities. A Board official noted that DCCA is aware that it is difficult for Reserve Banks to effectively respond to questions from the supervised institutions when they are not receiving sufficient information from the UDAP Enforcement and Fair Lending Enforcement sections.

In addition, interviewees from several Reserve Banks described DCCA's approach to providing guidance and assistance related to communications with supervised institutions as informal and inconsistent. Reserve Bank interviewees said that DCCA communicated to the Reserve Banks that they must refrain from discussing a potential UDAP violation with an institution. An official said DCCA does not want the Reserve Banks to share information with an institution because of the risk of providing inconsistent messages. According to a Reserve Bank official, one DCCA attorney may tell the Reserve Bank examiners not to speak to an institution unless that DCCA attorney also participates on the call, while another DCCA attorney will allow the Reserve Bank to communicate without participating. This same official noted that it is unclear whether the approach is driven by formal policy or the DCCA attorneys' personal preferences. Another Reserve Bank official explained that DCCA attorneys provided some guidance for the Reserve Banks' communications with supervised institutions but conveyed this guidance informally, which has led to confusion. Several Reserve Bank officials recommended that DCCA provide clear guidance on what information is appropriate to share and when it is appropriate to share the information with supervised institutions. An official noted it would be beneficial to have expectations for engaging with the institutions regarding UDAP matters. Multiple Reserve Bank interviewees noted that the lack of transparency regarding the status of matters under DCCA review and the lack of clarity on what may be communicated to institutions strains the Reserve Bank's relationship with the supervised institutions and presents reputational risk to the System.

## **Conclusion**

We believe that with the recently implemented fair lending milestones and the prospective development of performance goals and target milestones for UDAP discussed in finding 1, formal guidance that defines

expectations for communications (including formal expectations for providing status updates) may help enhance transparency into the supervisory processes. Further, we believe that DCCA can clarify the expectations and circumstances for sharing information with supervised institutions. We believe that increased transparency will help to facilitate examination scheduling and help Reserve Bank staff to better manage relationships with supervised institutions.

## Recommendations

We recommend that the director of DCCA

7. Develop expectations for communicating with and providing periodic status updates to the Reserve Banks on
  - a. UDAP matters, after establishing additional UDAP performance measures or targets pursuant to recommendation 1.
  - b. fair lending matters.
8. Clarify suggested approaches for coordinating internal communications for UDAP and fair lending reviews that require the input of multiple divisions or sections within DCCA.
9. After establishing the additional UDAP performance measures or targets pursuant to recommendation 1, develop a Systemwide tracking tool to share the status of UDAP matters that outlines the steps in the process, the person(s) responsible for completing the next step(s), and the expected completion date.
10. Identify what information the Reserve Banks can share with supervised institutions and develop formal guidance for communicating with supervised institutions regarding UDAP and fair lending matters.

## Management Response

In its response to our draft report, DCCA concurs with our recommendations. Specifically, in response to recommendation 7, DCCA states that by the end of the second quarter of 2022, it will develop expectations for communicating with and providing periodic status updates to the Reserve Banks on UDAP and fair lending matters. DCCA notes that with respect to UDAP, it currently implements communication strategies that provide opportunities for the UDAP Enforcement section, the Reserve Banks, and other stakeholders to share information about UDAP matters on a regular basis. DCCA also notes that with respect to fair lending, it has a number of communications strategies in place that it plans to continue, such as the examination timing tracker available to DCCA staff and Reserve Bank examiners, the existing monthly Fair Lending COP meetings to communicate with the Reserve Banks' designated fair lending points of contact, and regular touchpoints on fair lending matters with 9 of the 12 Reserve Banks at the Reserve Banks' request. DCCA states that it will ensure that any remaining Reserve Banks that do not currently have a recurring meeting scheduled with a member of the Fair Lending Enforcement section will have one scheduled by the end of 2021.

In response to recommendation 8, DCCA states that by the end of the second quarter of 2022, it will review the approaches for coordinating internal communications and make changes as appropriate to existing procedures to improve communications and enhance timeliness. Specifically, DCCA states that its

Oversight, UDAP Enforcement, and Fair Lending Enforcement sections will review and formalize an approach for communicating and sharing information on examination status and any other relevant issues arising in the examination. Further, DCCA notes that its UDAP Enforcement section will work with the Legal Division to clarify suggested approaches related to communications about UDAP matters to enhance the coordination between the UDAP Enforcement section and the Legal Division and will work with the Legal Division to clarify potential approaches for coordinating on fair lending matters where appropriate.

In response to recommendation 9, DCCA states that it is currently developing a Systemwide tracking tool to share information about UDAP matters. DCCA states that after establishing the additional UDAP performance measures or targets pursuant to recommendation 1, by the end of the third quarter of 2022 DCCA will revise the tracking tool currently being developed to expand its functions to include an outline of the steps in the process, identify the person(s) responsible for completing the next step(s), and track the expected completion dates for the steps in the UDAP review.

In response to recommendation 10, DCCA states that by the end of the third quarter of 2022, it will develop and formalize guidance for communicating with supervised institutions regarding general and procedural information about UDAP and fair lending. DCCA notes that it will continue outreach to supervised institutions on relevant UDAP and fair lending topics and that the System's communications with supervised institutions about the substantive details of an open UDAP or fair lending review will continue to be guided by an established process for communicating the agency's preliminary and final analyses.

## **OIG Comment**

The actions described by DCCA appear to be responsive to our recommendations. We will follow up to ensure that the recommendations are fully addressed.



# Appendix A: Scope and Methodology

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We initiated this evaluation to assess the efficiency and effectiveness of the Board’s and the Reserve Banks’ consumer compliance examination and enforcement action issuance processes, including the processes related to UDAP and fair lending matters. Specifically, this evaluation focused on the processes for reviewing UDAP and fair lending matters during consumer compliance examinations and the enforcement action issuance processes for UDAP and fair lending violations. The scope of our evaluation covered DCCA’s and the Reserve Banks’ consumer compliance examination activities at state member banks with total assets of \$10 billion or less (commonly referred to as *community banks*). Specifically, our scope included consumer compliance examinations with UDAP or fair lending matters that were closed or opened from January 1, 2017, to December 31, 2019. Our scope also included formal and informal UDAP- and fair lending–related enforcement actions (including memorandums of understanding, Board resolutions, supervisory letters, and cease and desist orders) issued from January 1, 2017, to December 31, 2019, and pending enforcement actions as of December 31, 2019, as well as related examination activities. Our scope did not include assessing the appropriateness of substantive outcomes related to the Board’s review of UDAP and fair lending matters, including whether enforcement actions were warranted.

We selected a nonrandom sample of three Reserve Banks—the Federal Reserve Bank of Chicago, the Federal Reserve Bank of Cleveland, and the Federal Reserve Bank of Kansas City—based on quantitative and qualitative factors. We then selected a nonrandom sample of consumer compliance examinations and a consumer complaint that included potential fair lending or UDAP matters at institutions supervised by the Reserve Banks in our sample.<sup>21</sup> Our samples are nonstatistical, and the results of our analysis cannot be extrapolated to the entire population of Reserve Banks or consumer compliance examinations and enforcement actions.

To accomplish our objective, we reviewed relevant laws and regulations (such as the Dodd-Frank Wall Street Reform and Consumer Protection Act and section 5 of the FTC Act); Board policies, procedures, and guidance (such as the DCCA *Consumer Compliance Handbook* and *Consumer Complaints Manual*); documentation and correspondence associated with the sample examinations and complaint (such as reports of examinations, UDAP and fair lending analysis documentation, preliminary analyses, and final analyses); and other relevant documentation (such as consumer compliance examination and enforcement action data). In addition, we reviewed the relevant policies and procedures, consumer compliance examination and enforcement action data, and other relevant materials of the Reserve Banks in our sample. For informational purposes, we reviewed documentation pertaining to the consumer compliance examination and enforcement action issuance processes of a sample of other federal financial regulatory agencies and interviewed agency personnel.

We conducted 90 interviews with Board and Reserve Bank staff and officials to gather their perspectives on the consumer compliance examination and enforcement action issuance processes. Specifically, we

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<sup>21</sup> We selected the consumer complaint because although examiners typically identify or review potential UDAP matters through the examination process, Reserve Bank staff may also refer potential UDAP violations to DCCA based on consumer complaints.

interviewed officials and staff from DCCA, the Board’s Legal Division, and the three Reserve Banks in our sample. Additionally, we interviewed members of the System’s CCMG from each of the 12 Reserve Banks.

We conducted our evaluation from February 2020 through May 2021. We performed our evaluation in accordance with the *Quality Standards for Inspection and Evaluation* issued in January 2012 by the Council of the Inspectors General on Integrity and Efficiency.

# Appendix B: Management Response



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C. 20551

ERIC S. BELSKY  
DIRECTOR  
DIVISION OF CONSUMER  
AND COMMUNITY AFFAIRS

August 31, 2021

Michael VanHuysen  
Associate Inspector General  
Audits and Evaluations  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Dear Mr. VanHuysen:

Thank you for the opportunity to comment on your report, *The Board Can Improve the Efficiency and Effectiveness of Certain Aspects of Its Consumer Compliance Examination and Enforcement Action Issuance Processes*. We appreciate the effort that the Office of the Inspector General (“OIG”) put into this report, the recognition that DCCA’s processes in this area continue to evolve, and the recommendations provided to enhance the timeliness and communications of the Board’s approach to consumer compliance supervision of unfair or deceptive acts or practices (“UDAP”) and fair lending laws. DCCA concurs with the recommendations in the report.

The Federal Reserve has supervisory authority for section 5(a) of the Federal Trade Commission Act (“FTC Act”) that prohibits unfair or deceptive acts of practices for all state member banks of the Federal Reserve System, regardless of a bank’s asset size. With respect to fair lending, the Federal Reserve has supervisory authority for the Equal Credit Opportunity Act (“ECOA”) for state member banks under \$10 billion in asset size and the Fair Housing Act for all state member banks regardless of a bank’s asset size. The Federal Reserve identifies UDAP and fair lending violations through consumer compliance examinations as well as consumer complaints regarding bank practices. Notably, the OIG’s evaluation focuses on a subset of UDAP and fair lending reviews, specifically those arising from exams for state member banks with under \$10 billion in assets.

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[www.federalreserve.gov](http://www.federalreserve.gov)

We agree that timeliness and efficiency are important goals of the UDAP and fair lending review processes. We also note that the programs are designed to ensure that the Federal Reserve:

- effectively identifies UDAP and fair lending risks and violations and ensures remediation by Federal Reserve regulated institutions
- consistently addresses similar practices across the Federal Reserve System
- transparently communicates with the regulated institutions our analysis and conclusions to provide the institutions with the opportunity to provide additional information
- complies with the statutory requirement to refer certain matters to the U.S. Department of Justice (“DOJ”).

As part of our continuous improvement approach to supervision, we regularly review and refine our UDAP and fair lending supervisory processes to improve, among other things, the timeliness and efficiency of those programs. For example, DCCA has enhanced the UDAP process in several different ways. Prior to 2015, the Fair Lending Enforcement section handled all UDAP matters. In response to a significant increase in UDAP matters being referred by Reserve Banks to DCCA for review, DCCA established the UDAP Enforcement section and expanded staffing through 2017. In 2017, DCCA further improved the UDAP process to include closer tracking and monitoring of matters. These steps were further enhanced in 2020. In 2018, DCCA established criteria defining non-complex matters and introduced a process and tailored approach to resolve some of these matters, including timing goals. In 2021, UDAP is undergoing a major process review that includes interviews with stakeholders and discussions of larger process changes. Likewise, in 2015, in consultation with the Reserve Banks, DCCA undertook a thorough business process improvement review of the fair lending process that led to timing goals and other changes aimed at improving timeliness. In 2017, DCCA further improved the efficiency, effectiveness, and consistency of examinations with a structured fair lending tool and supporting examiner resources. In 2020 and 2021, DCCA delegated the review of certain high-risk redlining matters to Reserve Banks, revised timing goals, and developed additional examiner job aids. Overall, the recommendations by the OIG complement, and addressing them will augment, these existing enhancements.

We appreciate that the report acknowledges that DCCA has a number of active communication channels and has taken several steps in recent years to improve fair lending processes and expand delegations to Reserve Banks for fair lending matters, as well as to improve the timeliness of both the fair lending and UDAP programs through steps such as introducing timing goals and job aids for fair lending reviews and piloting process improvements and timing goals for non-complex UDAP matters. These steps have resulted in improvements. As the report notes, the introduction in 2015 of the 20-week goal for determinations of preliminary findings of fair lending discrimination was met 90 percent of the time from October 2017 to June 2018. More recently, this goal for high-risk redlining reviews has been shortened to 15 weeks. Finally, since the report’s 2017-2019 evaluation period, the UDAP program has succeeded in significantly reducing the number of examinations that included UDAP reviews which were held open for extended periods.

These are important areas of consumer protection. We value the perspective the OIG brought to help us improve as we continue to evolve and enhance our supervisory programs for UDAP and fair lending.

Finding 1: DCCA Can Improve the Efficiency and Effectiveness of its Consumer Compliance Examinations and Enforcement Action Issuance Process for UDAP

Recommendation 1: Revise the approach for conducting UDAP reviews by

- a. reassessing the current approach for conducting UDAP reviews.
- b. establishing additional formal performance measures or targets for completing steps within the UDAP review process.
- c. defining criteria for determining when DCCA must review a potential UDAP matter.
- d. issuing guidance consistent with the results of that assessment.

Response: DCCA agrees with these recommendations. By the end of the fourth quarter of 2022, we will reassess DCCA's approach for conducting UDAP reviews in the following ways. As the OIG acknowledges, DCCA already has established a performance measure and target for completing the UDAP review process for noncomplex matters. We will establish additional formal performance measures or targets for completing steps in the UDAP review process. We will also have defined the criteria for determining which potential UDAP matters Reserve Banks will send to DCCA for review. DCCA will issue guidance consistent with the results of its assessment of the Federal Reserve's approach to conducting UDAP reviews, establishment of additional performance measures and targets, and specific criteria for determining when DCCA must review a potential UDAP matter.

Recommendation 2: Update CA Letter 12-7 to reflect program changes that have occurred since establishing the UDAP Enforcement section.

Response: DCCA agrees with this recommendation. By the end of the fourth quarter of 2022, DCCA will issue an update to CA Letter 12-7 that reflects changes that have been made to the UDAP program since the establishment of the UDAP Enforcement section.

Recommendation 3: Develop templates and other training materials to include case studies on UDAP matters for the Reserve Banks to distribute to their UDAP specialists and consumer compliance examiners. After developing the templates and training materials, DCCA should

- a. define the frequency for conducting periodic training.
- b. define a plan for providing case studies on a periodic basis to highlight emerging risks as well as frequent or common cases.

Response: DCCA agrees with these recommendations. By the end of the fourth quarter of 2022, DCCA will develop templates and other training materials that include case studies on UDAP matters for the Reserve Banks to distribute to their UDAP specialists and consumer compliance examiners, define the frequency for conducting periodic training for Reserve Banks, and define a plan for providing updated case studies on a periodic basis to highlight emerging risks as well as frequent or common cases.

Recommendation 4: Assess the current level of staffing within the UDAP Enforcement section to determine if staffing is appropriate to efficiently and effectively conduct UDAP reviews. As part of this assessment, consider the effect of prospective changes regarding how DCCA selects and prioritizes UDAP reviews.

Response: DCCA agrees with this recommendation. We created the UDAP Enforcement section in 2015 and were in the process of standing up that section when it lost staff due to promotion and internal transfer. Today, the section has been restored to full staffing levels, and we continue to evaluate our staffing levels. By the end of the fourth quarter of 2021, DCCA will assess the current level of staffing within the UDAP Enforcement Section to determine if staffing is appropriate in terms of staff position type and number to efficiently and effectively conduct UDAP reviews. DCCA's staffing assessment will consider the effect of prospective changes regarding how DCCA selects and prioritizes UDAP reviews.

Finding 2: DCCA Can Improve the Efficiency and Effectiveness of Its Consumer Compliance Examination and Enforcement Action Issuance Processes for Fair Lending Matters

Recommendation 5: Develop additional training to acclimate Reserve Bank staff and examiners to new roles and responsibilities resulting from the expanded redlining delegation to Reserve Banks.

Response: DCCA agrees with this recommendation. By the end of the second quarter of 2022, DCCA will provide additional training to Reserve Bank staff and examiners on the expanded redlining delegation and monitoring practices for expanded delegation. We will also continue to develop and update existing examiner job aids to assist examiners in conducting high-risk redlining reviews and will provide training on any updated jobs aids.

Recommendation 6: Evaluate the Fair Lending Enforcement section's current staffing structure and approach for reviewing Reserve Banks' RAM submissions.

Response: DCCA agrees with this recommendation. We are in the process of reviewing the section's current staffing structure in light of the expanded redlining delegation and monitoring practices for expanded delegation, cross-training existing staff to provide additional support, and updating existing staff's priorities to ensure all RAMs are reviewed under established timelines. We will evaluate the section's approach for reviewing Reserve Banks' RAMs by the end of the first quarter of 2022.

Finding 3: DCCA Can Clarify and Enhance Its Processes for Internal and External Communications

Recommendation 7: Develop expectations for communicating with and providing periodic status updates to Reserve Banks on UDAP and fair lending matters.

Response: DCCA agrees with this recommendation. With respect to UDAP, DCCA currently implements communication strategies that provide multiple opportunities for the UDAP Enforcement section, the Reserve Banks, and other stakeholders to share information about UDAP matters on a regular basis. By the end of the second quarter of

2022, DCCA will develop formal expectations for communicating with and providing periodic status updates to Reserve Banks on UDAP matters.

With respect to fair lending, DCCA has a number of communications strategies in place that we plan to continue. For example, DCCA has already developed and will continue to use and update the examination timing tracker, which is available to both section staff and Reserve Bank examiners. DCCA also will continue to use the existing monthly Fair Lending Community of Practice meetings to communicate with the Reserve Banks' designated fair lending points of contact. In addition, section staff already have regular touchpoints on fair lending matters with nine of the twelve Reserve Banks at the Reserve Banks' request. DCCA will ensure that any remaining Reserve Banks that do not currently have a recurring meeting scheduled with a member of the Fair Lending Enforcement section will have one scheduled by the end of 2021. By the end of the second quarter of 2022, DCCA will develop expectations for communicating with and providing periodic status updates to Reserve Banks on fair lending matters.

Recommendation 8: Clarify suggested approaches for coordinating internal communications for UDAP and fair lending reviews that require the input of multiple divisions or sections within DCCA.

Response: DCCA agrees with this recommendation. The DCCA Oversight section maintains an institution-level view of the entire consumer compliance examination process. The Oversight, UDAP Enforcement, and Fair Lending Enforcement sections will review and formalize the approach whereby they communicate and share information on the status of particular examinations and any other relevant issues arising in the examination.

With regard to communications between the UDAP Enforcement section and the Legal Division, the UDAP Enforcement section currently meets with the Legal Division on a regular basis to share information about UDAP matters. The UDAP Enforcement section will work with the Legal Division to clarify suggested approaches related to communications about UDAP matters to enhance the coordination between the UDAP Enforcement section and Legal Division. The Fair Lending Enforcement section also will work with the Legal Division to clarify potential approaches for coordination on fair lending matters where appropriate.

By the end of the second quarter of 2022, DCCA will review the suggested approaches for coordinating internal communications and make changes as appropriate to existing procedures to improve communications and enhance timeliness.

Recommendation 9: After establishing the additional UDAP performance measures or targets pursuant to recommendation 1, develop a Systemwide tracking tool to share the status of UDAP matters that outlines the steps in the process, the person(s) responsible for completing the next step(s), and the expected completion date.

Response: DCCA agrees with this recommendation. We are currently developing a systemwide tracking tool to share information about UDAP matters. After establishing the additional UDAP performance measures or targets pursuant to recommendation 1, by the end of the third quarter of 2022, DCCA will revise the tracking tool currently being developed to expand its functions to include an outline of the steps in the process,

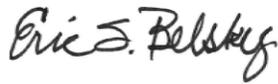
identify the person(s) responsible for completing the next step(s), and track the expected completion dates for the steps in the UDAP review.

Recommendation 10: Identify what information Reserve Banks can share with supervised institutions and develop formal guidance for communicating with supervised institutions regarding fair lending and UDAP matters.

Response: DCCA agrees with this recommendation. By the end of the third quarter of 2022, we will develop and memorialize formal guidance for communicating with supervised institutions regarding general and procedural information about UDAP and fair lending. We note that DCCA will continue outreach to supervised institutions on relevant UDAP and fair lending topics via the Federal Reserve publication *Consumer Compliance Outlook* and on fair lending topics through the annual Fair Lending Interagency Webinar, which is hosted by the Board. We also note that the Federal Reserve's communications with supervised institutions about the substantive details of an open UDAP or fair lending review will continue to be guided by an established process for communicating the agency's preliminary and final analyses.

We appreciate the effort that went into this report as we continue to evolve and build our supervisory programs for UDAP and fair lending. We are developing action plans to address the recommendations and meet the commitments in this response. These are important areas of consumer protection and we will continue to work to further enhance the efficiency of our programs.

Regards,



Eric Belsky  
Director  
Division of Consumer and Community Affairs



# Abbreviations

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<b>CCMG</b>	Consumer Compliance Management Group
<b>DCCA</b>	Division of Consumer and Community Affairs
<b>DOJ</b>	U.S. Department of Justice
<b>ECOA</b>	Equal Credit Opportunity Act
<b>Fair Lending COP</b>	Fair Lending Community of Practice
<b>FLOW</b>	Fair Lending Order of Work
<b>FTC Act</b>	Federal Trade Commission Act
<b>MRAs</b>	Matters Requiring Attention
<b>MRIAs</b>	Matters Requiring Immediate Attention
<b>RAM</b>	redlining analysis memorandum
<b>UDAAP</b>	unfair, deceptive, or abusive acts or practices
<b>UDAP</b>	unfair or deceptive acts or practices

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