

Financial Services

Risk Mitigation Strategies for Fair Lending and the Paycheck Protection Program

The recent U.S. Small Business Administration's (SBA) Paycheck Protection Program (PPP) initially consisted of one round of funding, which was quickly expanded to a second round. The first round included \$349 billion and was exhausted rapidly. The second round included \$310 billion,¹ and was focused on smaller loans, which led to it lasting longer. Throughout this time, regulators submitted guidelines and recommendations pointing to increased fair lending focus, including:

- **April 27, 2020:** The Consumer Financial Protection Bureau (CFPB) released a statement reminding servicers that they are expected to comply with the Equal Credit Opportunity Act in their extension of PPP loans to small businesses.² The statement:
 - Encouraged minority- and women-owned businesses to submit complaints through the CFPB's portal in the event they feel they have been discriminated against.
 - Emphasized “the importance of fair and equitable access to credit for minority- and women-owned businesses...”
 - Indicated that the CFPB plans to focus on denials of applications where the applicants meet the program requirements, inflated loan rates, and/or unequal loan terms.
 - April 27, 2020: The Office of the Comptroller of the Currency (OCC) encouraged lenders to “...prudently document their implementation and lending decisions” as they relate to the decisioning of PPP loans;³ and,
- **May 6, 2020:** The CFPB released a FAQ guide related to “The Bureau’s Equal Credit Opportunity Act and Regulation B FAQs related to the COVID-19 Emergency,”⁴ which primarily discusses the decisioning process and timelines.
- **June 14, 2020:** Members of the U.S. House of Representatives wrote letters to the largest American banks, requesting that they release demographic information related to PPP loans for investigations into their fair lending practices around PPP.

In anticipation of increased enforcement, lenders should prepare for risks in areas including applicant prioritization, inconsistent handling of PPP applications, and increased customer complaints. Guidehouse anticipates focused scrutiny on the loan-decisioning process and dispersion of loans as part of the fair lending reviews.

1. Small Business Administration, “Paycheck Protection Program,” <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>.
2. Consumer Financial Protection Bureau, Patrice Alexander Ficklin, Grady Hedgespeth, and Lora McCray, “The importance of fair and equitable access to credit for minority and women-owned businesses,” April 27, 2020, <https://www.consumerfinance.gov/about-us/blog/fair-equitable-access-credit-minority-women-owned-businesses/>.
3. Office of the Comptroller of the Currency, OCC Bulletin 2020-45, “Credit Administration Documentation of SBA Paycheck Protection Program Loans,” April 27, 2020, <https://www.occ.gov/news-issuances/bulletins/2020/bulletin-2020-45.html>.
4. Consumer Financial Protection Bureau, “The Bureau’s Equal Credit Opportunity Act and Regulation B FAQs related to the COVID-19 Emergency,” May 6, 2020, https://files.consumerfinance.gov/f/documents/cfpb_ecoa-regulation-b_faqs-covid-19.pdf.



Examples of Fair Lending Risks Associated With PPP

Throughout both rounds of funding there were multiple areas of fair lending risk that may arise from lending activities. Below are two example areas with potentially the greatest risk:

Applicant Prioritization & Access to Loans: During the first round of funding, lenders saw large waves of applications, leading many to resort to “gating” practices in processing PPP applications, where lenders prioritize PPP applications of already existing or larger customers. This has led to times where lenders have adopted policies of rejecting applicants that they do not already have a relationship with.

However, restricting or prioritizing applicants inherently introduces the risk that not all applicants, many of them substantively similar in size and situation, will be handled the same. There is also a risk that rejected or deprioritized applicants are disproportionately minority- and/or women-owned businesses.

Insufficient Documentation & Handling PPP in an Inconsistent Manner: In failing to review, update, and apply new and updated guidelines equally for all applicants, lender processors and underwriters may be unclear as how to equitably process applications. This can create an unintentional disparity between PPP loan applications' processing times, approved loan limit amounts, and documentation requirements. Any disparities stemming from poorly developed lending guidelines can result in heightened fair lending risk.

The above are example risks resulting from increased regulatory scrutiny for lenders. As regulatory entities have increased guidance on fair lending associated with PPP activities, lenders should take steps to mitigate these risks as outlined on the next page.



Example of Mitigative Measures for Fair Lending Monitoring

To address the possibility of regulatory action, lenders should take action to mitigate fair lending risks associated with PPP. For institutions that participated in PPP, Guidehouse recommends the following steps to be prepared for regulatory scrutiny and mitigate risks:

	Document All Policies, Procedures, Processes, & Exceptions for PPP Loans	Conduct Statistical Analysis to Determine Fair Lending Risk	Establish Process for Loan Monitoring and Loan Forgiveness
Key Activities	<ul style="list-style-type: none"> Document historical PPP lending process Document process for obtaining any and all missing docs from applicants Document process for recording exceptions of historical PPP lending Outline fair lending testing plan Document inclusion of PPP lending as part of CRA credit and highlight CRA tracking process. 	<ul style="list-style-type: none"> Conduct statistical regression analysis on data collected for PPP lending to highlight any fair lending disparities Statistical analysis and regression data should include areas such as: <ul style="list-style-type: none"> Loans previously denied but approved after reapplying; Approval and denial rates; Disparities between approval rates for different entity types; Inconsistent application processing times; and, CFPB and internal complaints data. 	<ul style="list-style-type: none"> Ensure a process is set to monitor loans since forgiveness requests are expected. Include the following steps: <ul style="list-style-type: none"> Receive the borrower certifications in the loan forgiveness form; Receive appropriate borrower documentation; and, Confirm any borrower calculations on the forgiveness form, as specified by the SBA.
Outcomes	<ul style="list-style-type: none"> Robust documentation of Policies and Procedures (P&Ps) that will provide examiners insight into PPP lending Documentation of divergence from current PPP guidance to ensure that special cases are not violating fair lending regulations 	<ul style="list-style-type: none"> Statistical and/or regression results identifying any potential disparities in lending activities Matched pair analysis of any statistically significant disparities identified 	<ul style="list-style-type: none"> A well-documented approach to transition to the next phase of the PPP program

Document All Policies, Procedures, Processes, and Exceptions for PPP loans: Lenders should review their lending documentation to determine whether any current or future P&P, processes, and guidelines can cause demographic disparities in PPP loan approvals. Lenders should review areas such as:

- Application “gating” or “stacking”;
- Collection of demographic data;
- Loan documentation requirements;
- Any PPP loan exceptions along with clear documentation as to why the exception occurred;
- A process of second-level review for any PPP loan denials; and,
- Enhanced PPP documentation requirements not required by the SBA.

If any of the above areas are not included in formal documentation, lenders should take steps to enhance the procedures and historical decisioning documentation to encompass them. Further, appropriate documentation can not only help ensure appropriate governance over the program, it also promotes consistency among analysts and underwriters.

Conduct Statistical Analysis of Lending Practices to Determine Fair Lending Risk: In monitoring the effects of a lender’s policies and procedures, lenders should conduct fair lending statistical and/or regression analysis of historical PPP lending practices to understand potential fair lending risks. In conducting a fair lending statistical/regression analysis, lenders should consider fair lending areas including:

- Loans previously denied but approved after reapplying;
- Approval and denial rates;
- Disparities between approval rates for different entity types;
- Inconsistent application processing times; and,
- CFPB and internal complaints data.

Performing such analyses will allow lenders to understand any lending disparities and proactively determine if they need to provide restitution for fair lending violations and prepare justifications for any acceptable exceptions in advance of regulatory action.

Establish Process for Loan Forgiveness: Lenders should be prepared for the loan forgiveness component of PPP lending. Based on the current guidelines established by the SBA, a PPP loan is to be forgiven when the lender confirms that the following has occurred:

- Lender receives the borrower certifications in the loan forgiveness form;
- Lender receives appropriate borrower documentation; and,
- Lender confirms any borrower calculations on the forgiveness form, as specified by the SBA.

As lenders transition to loan forgiveness, they should document all policies and procedures, collect fair lending data, perform statistical analyses for PPP loan forgiveness, set up mechanism for tracking of forgiveness based on protected class, and document any exceptions.

Next Steps for Lenders

Guidehouse suggests that lenders begin to take the steps necessary to help prepare for anticipated increased regulatory scrutiny. Lenders should prepare by building out an appropriate fair lending review process of PPP loans based on areas including documentation of policies and procedures, statistical and/or regression analysis, and establishing a process for loan monitoring and forgiveness. Although these steps may not be exhaustive of all fair lending reviews that could be performed on the PPP loan process, these will help establish a solid framework and serve as justification to regulators for lending activities.



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