



# Fair Lending Update

*2012*

*Banker Outreach Program*





# Fair Lending

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- Discussion Topics:
  - Fair Lending High Risks Areas
    - Pricing and Underwriting
  - Examination Focus and Procedures
  - How to Conduct a Comparative Analysis
  - Redlining Risk
  - Steering Risk
  - Third-party Risk – Disparate Impact



# Fair Lending

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- Discussion Topics (Continued):
  - Spousal Signature Risk
  - Credit Report Risk
  - Age-Based Deposit Account Risk
  - Best Practices & Lesson Learned



# Fair Lending

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- Fair Lending Examination

- FDIC examiners conduct a fair lending examination in conjunction with every scheduled compliance examination
- Examiners follow the Interagency Examination Procedures to conduct a risk-focused examination

# FFIEC Interagency Procedures

## ARE:

Designed to be a menu from which you select steps and ideas that best guide your judgment.

## ARE NOT:

A recipe that you must follow step by step.



# Scope of the Fair Lending Review

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- Is there a sufficient risk factor to warrant the selection of a focal point to evaluate a bank's lending "practices" either by a comparative file analysis or statistical regression analysis?

If so...

- What is the Focal Point and issue, i.e. greatest area of risk?



# Fair Lending Risks

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- High Risk Areas Identified During Examinations
  - Pricing
    - HMDA Institutions: Disparities in the incidence of reporting Higher-Priced loans and Average Rate Spreads (APR)
    - Other Loans (Consumer Unsecured / Vehicle): Disparities in Rates
  - Underwriting
    - HMDA Data Disparities in approvals/denials
  - Redlining
    - Disparities in geographic lending patterns



# Fair Lending Risks

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- High Risk Areas Identified During Examinations
  - Steering
    - Disparities in loans made through different channels or through different programs
  - Third-Party Risk – Disparate Impact
  - Non-Applicant Spousal Signature Issues
  - Credit Report Issues – Married Applicants versus Non-Married Applicants
  - Age-Based Deposit Accounts with Credit Features



# Fair Lending Risks

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- Pricing Risk – Pricing risks continue to be evident (HMDA Data and Consumer Loan Trial) based on discretionary guidance provided to loan officers without internal controls and monitoring procedures coupled with pricing disparities identified in Banks' loan products.
- Underwriting Risk – Emerging risk based on the lack of definitive underwriting standards and guidelines, and over-reliance on loan officers' experience level without internal controls and monitoring procedures coupled with denial disparities identified in HMDA data.



# Risk Indicators - Pricing

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- Presence of broad discretion in loan pricing;
- Use of risk-based pricing that is not based on objective criteria or applied consistently;
- Substantial disparities among prices being quoted or charged to applicants of a prohibited basis;
- Consumer complaints alleging discrimination in loan pricing; and



# Risk Indicators - Pricing

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- In mortgage pricing, disparities in the incidence or rate spreads of higher-priced lending by a prohibited basis as reported in the HMDA data.



# Pricing Case Study

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## Unsecured Consumer Loan Product

Rate Guidance 14% to 18% - exceptions allowed

### Rate Factors

- DTI – 36% Maximum
- Credit Score – 650 Minimum
- “Good” Loan & Deposit Relationship/History with Bank
- Employment & Residency – 1 Year Minimum



# Pricing Case Study (Con't)

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## Price 4 Loans – Approved in Underwriting – \$1,000 for 12 Months

### Customer A

CS 670, DTI 34%, Good 20+Yr Dep/Loan History, +1Yr  
Employ/Residency, \$600 Savings Balance, \$5000 Secured  
Loan Balance

### Customer B

CS 650, DTI 19%, No History, New \$100,000 CD Deposit ,  
+1 Yr Employ/Residency

### Customer C

CS 775, DTI 20%, No History, +1 Yr Employ/Residency

### Customer D

CS 640, DTI 35%, Good 10+Yr Dep/Loan History, +1Yr  
Employ/Residency, \$5000 Checking Bal, \$1MM Coml Loan with  
Excellent 5 Yr History



# Risk Indicators - Underwriting

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- Substantial disparities among the approval and denial rates;
- Vague or unduly subjective underwriting criteria;
- Lack of clear guidance on making exceptions to underwriting criteria including credit scoring overrides;



# Risk Indicators - Underwriting

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- Lack of clear loan file documentation; and
- Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs.



# Fair Lending- Examination Focus

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- HMDA Data - Underwriting/Pricing issues- All HMDA Reporters will undergo some form of underwriting and pricing analysis at all compliance examinations.
  - The HMDA data continues to be a good tool for examiners (and your bank) to identify the **potential for discriminatory lending practices.**
  - It is important to note that initial disparities in the raw HMDA data does not necessarily equal discrimination. The data simply identifies a need for further review.



# Fair Lending- Examination Focus

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- Examiners evaluate the HMDA data for disparities on a prohibited basis in:
  - The incidence of a bank reporting “higher-priced” loans
  - Average Rate Spread
  - Percentage of loans Reported as HOEPA Loans
  - Disparities in the incidence of reporting higher-priced loans, average rate spreads, and/or percentage of HOEPA loans will usually result in some type of additional review, and
  - Denial rate disparities



# Fair Lending- Examination Focus

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- Non HMDA Lenders:
  - Generally review the loan trial for previous 12 months (including paid-off loans)
  - Primary product lines reviewed:
    - Residential products
    - Consumer loan products
  - Determine if any pricing disparities (before controlling for pricing criteria) are noted initially based on the gender or ethnicity of the borrower.
    - Interest Rate – Not APR
    - Loan Fees – Review Separately



# Fair Lending- Examination Focus

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- In addition to reviewing HMDA data or the bank's loan trial to identify disparities in underwriting and pricing on a prohibited basis, examiners conduct an initial interview with management to understand the overall credit operations and to comprehend how the bank identifies, manages, and controls its fair lending risk.
- Keep in mind this equation:
  - *Initial Disparities (symptom) + Pricing Discretion (symptom) = File Review*



# Fair Lending- Examination Focus

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- If the examination scoping process identifies significant fair lending underwriting or pricing risk factors, the examiner develops a focal point for the examination.
- A criteria interview is conducted
  - Purpose of the criteria interview is to obtain the specific criteria that loan officers use to make decisions.
  - The information provided by management in the interview must be accurate and comprehensive.  
**Affirmation of the bank's criteria will be obtained in writing after the criteria interview.**



# Fair Lending- Examination Focus

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- Critical point: Bank personnel interviewed should have in-depth operational knowledge of the loan product under review and can explain to the examiners who makes decisions and how they are made.
- Examiners use the criteria interview information provided by management to determine the quantitative factors and variables to use in a comparative file review or statistical analysis.



# Fair Lending- Examination Focus

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- Comparative File Review or Statistical Analysis
  - Examiners gather information from each loan file relative to the bank's underwriting or pricing criteria.
  - A comparative file analysis or statistical analysis is conducted that incorporates the underwriting or pricing criteria provided by management as result of the criteria interview.
  - Analysis may show that once we control or account for the quantitative lending criteria, there is no evidence of discrimination.



# Comparative File Analysis

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- Prepare data collection instrument.
- Determine appropriate samples.
- Extract data from prohibited basis group files.
- Determine benchmarks.
- Review control group sample and extract data from overlaps.
- Conduct comparative analysis.



# Fair Lending Glossary

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- **Applicant Profile Spreadsheet** - A spreadsheet that includes categories of data to be recorded for each applicant.



# Prepare Data Collection Instrument

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- An applicant profile spreadsheet should be prepared that identifies data (name, loan number, date, etc.) for the loan product and lender based on the applicable underwriting criteria.



# Extract data from Applicants files

- Extract data from Target and Control group files in accordance with the applicant profile spreadsheet based on the criteria interview.



# Fair Lending Glossary

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- **Benchmark** - The best qualified denied applicant for each of the reasons for denial.



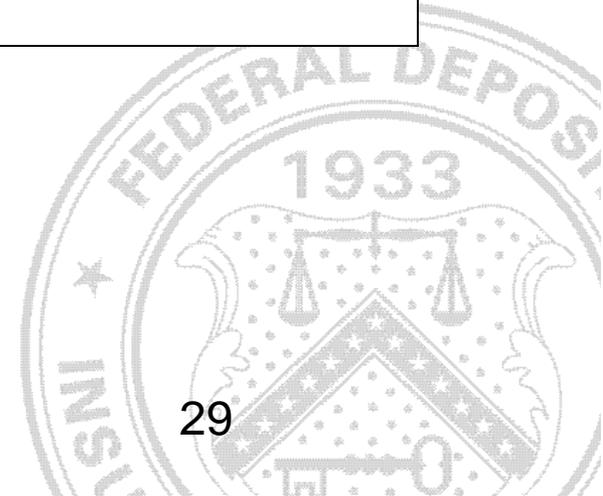
# Determine Benchmark(s)

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- Arrange or sort data collected for the denied applicant files by reason for denial, from best qualified to worst qualified.
- Select the benchmark for each reason for denial.

# Determine Overlap(s)

- Review the control group sample to determine if approved overlaps exist.
- Review target and control group applicants for denied overlaps.



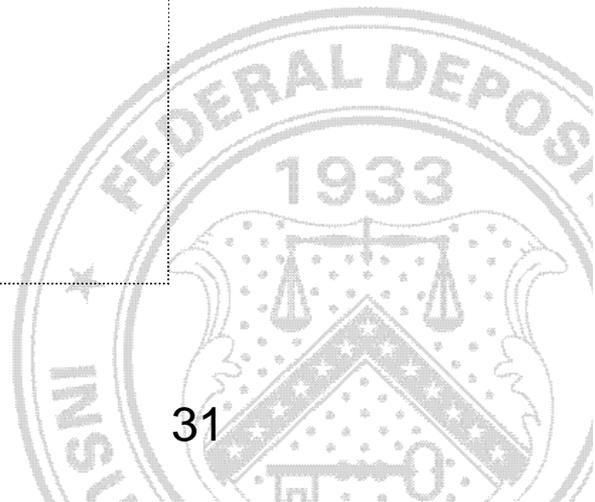
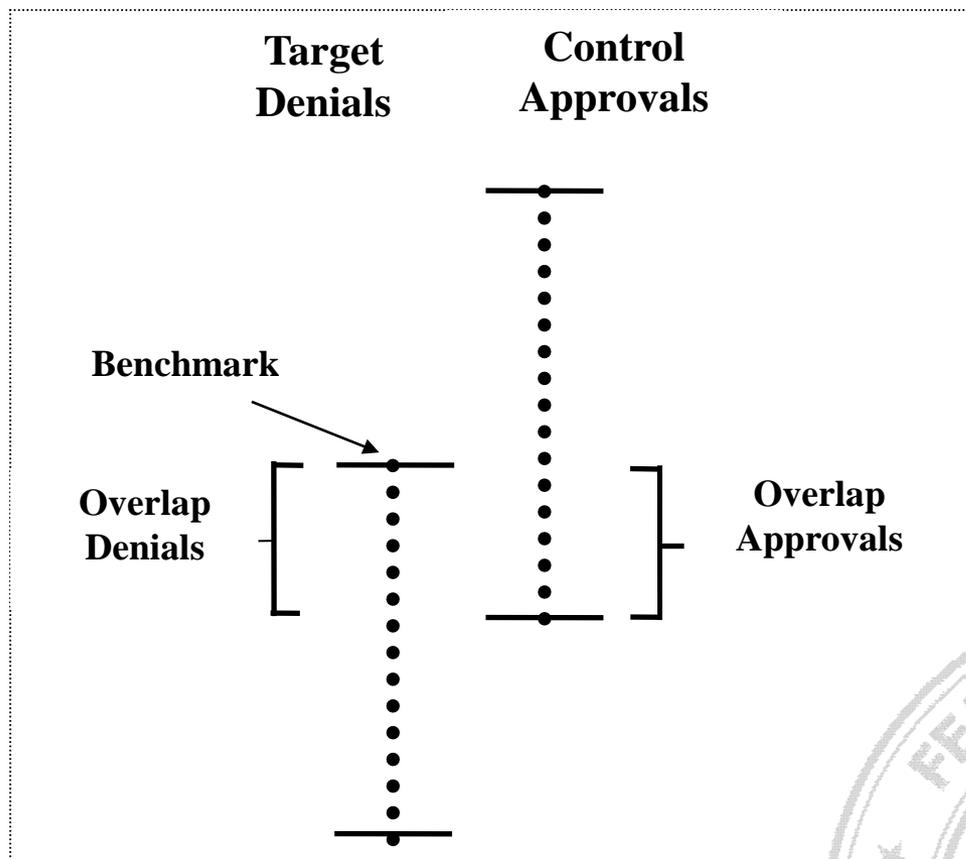


# Fair Lending Glossary

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- **Overlap Approval(s)** - Control group applicant(s) that appear no better qualified than the denied benchmark applicant under each category.
- **Overlap Denial(s)** - Target group applicant(s) under each category (other than the benchmark applicant) that appear to be as well qualified as the least qualified control group overlap.

# Overlap Denials & Approvals





# Comparative File Analysis

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- Transactional Underwriting
- Benchmarks Per Each Denial Reason (Target Group)
- Overlap Approvals (Control Group)
- Overlap Denials (Target Group)
  - Terms and Conditions Pricing
- Benchmarks Per Each Pricing Criterion (Target Group)
- Overlaps Per Pricing Criterion (Control Group)
- Overlaps Per Pricing Criterion (Target Group)



# Comparative File Analysis

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- Detect apparent difference in treatment.



# Recap: Comparative File Analysis

- Prepare data collection instrument.
- Determine appropriate samples.
- Extract data from prohibited basis group files.
- Determine benchmarks.
- Review control group sample and extract data from overlaps.
- Conduct comparative analysis.



# Fair Lending Redlining

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- Significant differences in the number of applications received, withdrawn, approved not accepted, and closed for incompleteness or loans originated in those areas in the institution's market that have relatively high concentrations of minority group residents;
- Significant differences between approval and denial rates for all applicants in areas with relatively high concentrations of minority group residents;



# Fair Lending Redlining

- Significant differences in the number of originations of higher-priced loans or loans with potentially negative consequences for borrowers in areas with relatively high concentrations of minority residents;
- Explicit demarcation of credit product markets that excludes MSAs, political subdivisions, census tracts, or other geographic areas within the institution's lending market or CRA assessment areas and having relatively high concentrations of minority residents;



# Fair Lending Redlining

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- Difference in services available or hours of operation at branch offices located in areas with concentrations of minority residents; and
- CRA assessment area appears to have been drawn to exclude areas with relatively high concentrations of minority residents.



# Fair Lending Redlining

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Examiners will review:

- Bank Assessment Area to determine the composition of “significant” minority-comprised census tracts and non-minority census tracts
- If significant minority census tracts (or neighborhoods) are evidenced, examiners will conduct a geographic distribution of Residential/Consumer Loans to determine where you are originating loans.



# Fair Lending Redlining

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Examiners will review:

- The reasonableness of the banks lending as compared to a number of factors including:
  - The percentage of significant minority tracts comprised within the assessment area
  - Branch locations and lending strategies
  - Demographic data
  - Marketing Strategies
  - Record of other banks (Peer) operating within the significant minority areas.



# Fair Lending Steering

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- Lack of clear, objective and consistently implemented standards for
  - (1) referring applicants to subsidiaries, affiliates, or lending channels within the institution;
  - (2) classifying applicants as “prime” or “sub-prime” borrowers; or
  - (3) deciding what kinds of alternative loan products should be offered or recommended to applicants.



# Fair Lending Steering

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- For an institution that offers different products based on credit risk levels, any significant differences in percentages of prohibited basis groups in each of the alternative loan product categories;
- Significant differences in the percentage of prohibited basis applicants in loan products with specific features relative to control group applicants;



# Fair Lending Steering

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- Institutions that have one or more lending channels that originate the same loan product, any significant differences in the percentage of prohibited basis applicants in one of the lending channels compared to the percentage of prohibited basis applicants of the other lending channel; and
- Consumer complaints alleging discrimination in residential loan pricing or product placement.



# Fair Lending Steering

- Steering**
  - Establish clear & objective standards for referring applicants to subsidiary, affiliates or other lending channels:**
    - Classifying applicants as prime or sub-prime borrowers; and**
    - Deciding alternative loan products**
  - Monitor lending**
  - Review compensation agreements**
  - Reminder: Final decision of choice of loan product is the applicants. Harm is not required to prove steering.**



# Fair Lending Third Party Risks

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Under ECOA, A Creditor is:

- any person who participates in a credit decision, including setting the terms of credit... including an assignee or a potential purchaser who influences the decision, transferee or subrogee.



# Fair Lending Third Party Risks

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Creditor may be responsible for violations by brokers and other agents if they:

“knew or had reasonable notice of the act, policy or practice that constituted the violation”



# Fair Lending Third Party Risks

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The best way to avoid compliance and reputation risk is to be Proactive.

Evaluate your third party lending practices like you evaluate your direct loans.



# Fair Lending Third Party Risks

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A robust risk management program is Essential and should evaluate third parties as followed:

- Communicate clearly that discrimination is not tolerated – in contract language and otherwise.
- Check their policies and corporate direction on discrimination.



# Fair Lending Third Party Risks

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- Require clear guidelines for processing applications, deciding creditworthiness, and setting prices.
- Insist on a system for recording how and why decisions were made, who made them, with explanations for any departures from ordinary rules.
- Be sure that third parties train employees on the policies, procedures and record-keeping requirements.



# Fair Lending Third Party Risks

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- Review everything – including the data

Assess Fair Lending Performance by:

- Analyze your data as a whole and third party's data separately.
- Within product areas AND between product areas.



# Fair Lending Third Party Risks

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- Look for disparities that correlate with
  - Race, gender or ethnicity
  - Minority areas
- Evaluate performance at all stages
  - Underwriting
  - Terms and Conditions
  - Redlining
  - Steering



# Fair Lending Third Party Risks

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- Investigate cause of problematic patterns
- As appropriate
  - Address the causes and reduce disparities
  - Quickly redress problems

Refer to Revised FFIEC Interagency Fair Lending Examination Procedures



# Fair Lending Spousal Signatures

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- Spousal Signature / guarantee**
  - Establish procedures regarding spousal signature;
  - Document file to evidence how and why signature was obtained; and
  - Sample files to test policy.
  
- Joint Applicants**
  - Documentation: Notice of Intent for Joint Application



# Fair Lending Credit Reports

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- **Emerging Issue 1**
- The first issue has been when banks charge a different credit report fee to married joint applicants who obtain a merged credit report (ex. \$30) than is charged to unmarried joint applicants who obtain two individual credit reports (ex. \$30 each or \$60). In such cases, an overt discrimination violation would be cited since a different credit report fee is charged on the basis of marital status. The fact that the charge for credit reports is different substantiates the violation, not whether one group was harmed.



# Fair Lending Credit Reports

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- **Emerging Issue 2**

- The second issue has been when banks do not charge a different credit report fee (merged vs. individual) or when the same fee is charged for joint applicants, regardless of marital status. Since there is no difference in fees charged, you might initially conclude that no violation exists. However, analysis of the fees charged is only the first step in determining whether discrimination is present.



# Fair Lending Credit Reports

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- **Emerging Issue 2 (Continue)**
- The next step is to determine whether the bank's evaluation or analysis of credit bureau reports is different based on marital status, regardless of fees charged. Any difference in the evaluation process between married and unmarried joint applicants would constitute a violation for different treatment on the basis of marital status. Therefore, examiners will analyze a bank's process for evaluating credit reports (merged vs. individual) for married joint applicants and unmarried joint applicants during the fair lending review.



# Fair Lending Deposit Accounts

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## **Age-Based Deposit Accounts**

- Credit Features tied to deposit account**
  - Overdrafts**
  - Bounce Protection**
  
- Age must be 62 and older**
  
- Review products for Fair Lending**



# Fair Lending Deposit Accounts

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- Most Common Violation : The difference in treatment involves one or more credit features.
- Examples of this would be when an annual fee for credit cards or overdraft lines were waived for the age restricted account holder but not others, or when an interest rate discount (on a loan product) is offered to the age restricted account category but not others.



# Fair Lending Deposit Accounts

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- Impacted customers requiring reimbursement would be those customers under the age limit set within the "age based account" that also opened the related credit product but paid more for that product just because they were excluded from the qualifying deposit account due to their age.



# Fair Lending- Best Practices

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- What Banks Can Do to Mitigate Risk?
  - First identify what your risks are by conducting periodic fair lending risk assessments:
    - The risk assessment should evaluate all of the credit products and services the bank offers, its organizational structure and lending channels, as appropriate.
      - Keep in mind that the collections and loss mitigation areas of your credit operations should also be evaluated to ensure consistent treatment between borrowers in determining whether to arrange a loan modification or a workout arrangement and the terms and conditions offered.
    - Based on the results of your risk assessment, adopt a **Proactive** approach to developing sufficient internal controls to reduce fair lending risks to your institution.



# Fair Lending- Best Practices

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- What Banks Can Do to Mitigate Risk?
  - The Board and Senior Management should clearly understand and convey to all personnel that everyone is responsible and accountable for complying with the fair lending laws and regulations.
  - The Board and Senior Management must ensure that underwriting and pricing criteria is clearly defined and understood by all lending personnel.
  - If lending personnel are allowed to deviate from underwriting or pricing criteria, the Board and Senior Management must ensure that the reason for deviations are clearly defined and documented.
  - Monitoring of pricing decisions is essential!!! This is very important and a key component of an effective fair lending compliance management program!!!



# Lessons Learned

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- Removing discretion in pricing decisions reduces risk of discrimination
- Documentation minimizes questions
- Comprehensive information enables accurate analyses
- Monitoring of pricing decisions is critical



# Lessons Learned

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- The accuracy of the HMDA data is crucial.
- Ensure that personnel responsible for maintaining and reporting your HMDA data clearly understand the collection and reporting requirements related to all data elements, especially the pricing and government monitoring information fields (ethnicity, race and gender)
- Inaccurate collection and reporting of HMDA data resulting in significant violations could subject the bank to civil money penalties.



# Final Thoughts

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- Any discriminatory violations found against the bank on any of the prohibited bases (Section 202.4 – Regulation B or Section 100.130 of the Fair Housing Act) will have an adverse impact on a bank’s compliance and CRA examination ratings. Not only that, the violation(s) will be included in your bank’s CRA Public Evaluation – an evaluation that is available for review by the public.

# Fair Lending

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***QUESTIONS??***





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**THANKS FOR YOUR  
PARTICIPATION TODAY!**

