Fair Lending Risk Assessments

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Fair Lending Examination Specialists

Presentation Overview

- Introduction
- Performing Risk Assessments
- Utilizing Risk Assessments

Introduction

Purpose of call: To discuss risk assessments.

- ❑ How to perform an assessment
- ❑ How to use an assessment
- ❑ Q&A opportunity

Risk assessment defined: An effort to identify and measure the risk inherent in the bank's lending processes and to determine what control and monitoring mechanisms are in place to protect against illegal discrimination.

Introduction (Continued)

Risk assessments identify risks and provide clues as to how to minimize/avoid risk.

Three sources of fair lending risk:

1. Overtly discriminatory policies and practices.
2. Unnecessary application of a nondiscriminatory policy that has a discriminatory effect.
3. Adverse use of discretion in the lending function relative to a prohibited bases.

Performing Risk Assessments

- Regulatory agencies follow a risk-based fair lending exam process.

- Goal is to establish scope of the exam, and considers:
  - Loan products
  - Markets
  - Decision centers
  - Time frame
  - Prohibited basis and control groups

- Combination of these elements = "Focal Point" to be reviewed.

Performing Risk Assessments (Continued)

- Bank approach should be similar but more in-depth.

- First step: Inventory all areas where risk is possible.
  - Will help develop a strong understanding of the bank’s credit processes.

Performing Risk Assessments (Continued)

Review:

- ❑ Written policies and procedures
- ❑ Board and management reports
- ❑ Training records

Consider:

- ➢ Organization's structure
- ➢ Complexity of product offering & delivery channels
- ➢ Demographics of the trade area/CRA assessment

Performing Risk Assessments (Continued)

Look for:

- Overtly discriminatory statements
  - In written documents and in officer/employee interviews
- Differences in assistance provided to certain applicants
- Subjective language.

Performing Risk Assessments (Continued)

Discretion = Risk

Consider:

- **Frequency and significance**
- **Controls in place to limit discretion**
- **Monitoring efforts**
- **Compensation agreements**

Performing Risk Assessments (Continued)

Review:

- ❑ Board and management reports
- ❑ Audit findings / Self-testing results
- ❑ Board approval of policies

Consider:

- ➢ Level of oversight
- ➢ Filtering by senior management
- ➢ Training effectiveness

Performing Risk Assessments (Continued)

Review:

- ❑ Organizational structure and complexity

Consider:

- ➢ CO independence/authority
- ➢ Discretion in various delivery channels
- ➢ Complexity of product offering
- ➢ Melded policies after acquisition or merger

Performing Risk Assessments (Continued)

Review:

- ❑ Demographics of the area
- ❑ Product development process
- ❑ Complaints resolution process

Consider:

- ➢ Potential for redlining
- ➢ Bias or predatory intentions
- ➢ Evidence of complacency

Performing Risk Assessments (Continued)

Mitigating controls

- Limits on loan pricing discretion
- Documentation requirements

Performing Risk Assessments (Continued)

Review

- ❑ Actions of subsidiaries, affiliates, and third parties

Consider:

- ➢ Explicit prohibited basis identifiers
- ➢ Credit scoring system that considers a prohibited basis
- ➢ Overtly discriminatory statements
- ➢ Disparities in denials or application processing times
- ➢ Disparities in w/drawn or incomplete applications
- ➢ Vague or subjective underwriting criteria

Performing Risk Assessments (Continued)

Review

- ❑ **Actions of subsidiaries, affiliates, and third parties (cont.)**

Consider:

- ➢ **A lack of guidance on exceptions**
- ➢ **Compensation based on loan volume or pricing**
- ➢ **Presence of broad discretion**
- ➢ **Unreasonable risk-based pricing**
- ➢ **Indications of steering or redlining**
- ➢ **Customer complaints**
- ➢ **Percentage of prohibited basis institution applicants vs. subsidiary applicants**

Performing Risk Assessments (Continued)

Review

- ❑ **Actions of subsidiaries, affiliates, and third parties (cont.)**

Consider:

- ➢ **Lack of standards for referring applicants to subsidiaries or offering alternative products**
- ➢ **Significant differences in percentages between prime and sub-prime borrowers**
- ➢ **Broad loan officer discretion**
- ➢ **Location of branches for lender vs. sub-prime mortgage subsidiary**
- ➢ **Significant differences between lending in high- vs. low-minority areas**
- ➢ **Demarcation of credit product markets that exclude areas with a high concentration of minority residents**

Performing Risk Assessments (Continued)

Review

- ❑ **Actions of subsidiaries, affiliates, and third parties (cont.)**

Consider:

- ➢ Policies relating to the processing of loans that vary between high- and low-minority areas
- ➢ Employee statements that are discriminatory in nature
- ➢ Complaints that indicate that the lender restricts access to credit in high-minority areas
- ➢ Advertising practices
- ➢ Proportion of prohibited basis applicant is significantly lower than the percentage of these groups in the total population of the market area

Performing Risk Assessments (Continued)

Use of Surrogates:

- First name
- Surname
- Residence address

Performing Risk Assessments (Continued)

Measurement – The Final Step

Consider:

- Volume of transactions
- Severity of possible adverse impact
- Level of compensating controls / monitoring

Determine:

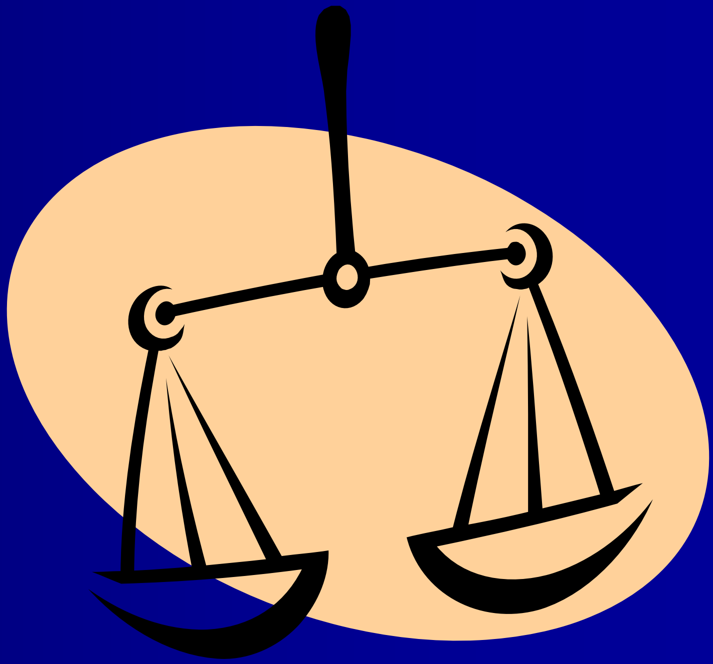
- ❑ Level of Risk Exposure
- ❑ Need for additional compensating processes
- ❑ Appropriate remedies for identified discrimination

Utilizing a Completed Assessment

The assessment shows…	Possible action warranted
No monitoring of underwriting discretion.	Implement secondary lender review and periodic audit.
No limitations on compensation incentives linked to higher loan pricing or overages.	Establish annual and per loan caps on lender compensation. Implement self-testing or audit to detect predatory pricing.
No oversight of third-party loan servicing activity.	Implement periodic reviews to determine whether discretionary actions by the third party are consistent without regard to prohibited basis.
Identified instances of discrimination.	Change policies and training program, seek legal advice, compensate victims, take appropriate action against the personnel involved.

Fair Lending Risk Assessments

Questions?



Regional Fair Lending Specialists

Please direct any questions or concerns regarding issues discussed in this presentation to the Fair Lending Examination Specialist in your region.

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