Questions & Answers from
July 17, 2013 New York Region Fair Lending Banker Call
As of August 21, 2013

Below please find the questions that were asked over the phone during the 07/17/2013 Fair Lending call.

1. Comment: Spousal signatures requirements for non-qualifying spouses on FHA loans.

   FLEX Chaloux requested that the specifics of this question be presented through email as it would require some research into FHA requirements. As of the completion of the written responses to the questions, an email was not received from the caller.

2. Comment: CFPB's mortgage rules (specifically QM) and the struggle between complying with the rules and compliance with Fair Lending and CRA.

   Regional Director John Vogel and Deputy Regional Director Scott Strockoz responded to this question. It was noted that this is a question that is often received from the industry and FDIC management continues to work with the CFPB to address FDIC-supervised bank concerns. As an indication of the CFPB's willingness to respond to community bank concerns, there have been recent amendments to the final rules announced in January which changes some of the QM rules for smaller banks (under $2 Billion in assets or less than 500 loans).

3. Comment: CRA loans to Habitat for Humanity are in jeopardy (not qualifying for QM) because they won't fit the QM definition due to DTI (debt-to-income ratio).

   Regional Director Vogel and DRD Strockoz also addressed this question. It was noted that it is important that banks can continue to support programs like Habitat for Humanity through lending. While not all residential loan programs will meet the QM standard, the FDIC anticipates loans can still be made that fall within acceptable risk levels. QM should not prohibit banks to continue to offer loan products that meet the credit needs of the community.

4. Question: A bank had a question about their policies on pricing loans differently based on the applicant's credit score. Are there any "best practices" or appropriate ways to implement this policy and be in compliance with Fair Lending?

   FLEX Chaloux noted that many banks follow a risk based pricing and it is not a practice discouraged by the regulatory agencies. The FDIC does expect that if a rate sheet has a given rate for a given credit score, that rate should be consistently applied. If consistently applied, any regression analysis would match the rate to the corresponding credit score of the applicant to test the bank's practices.

The caller then asked a follow-up question regarding the use of a range of credit scores on the rate sheet.

FLEX Chaloux noted that as long as it was a single rate applied to a range of credit scores, the FDIC would still look for consistency of application to all similar customers. However, if there were a range of interest rates to a given credit score it would be viewed as discretionary pricing because someone would be allowed to quote different rates for similarly qualified customers. The discretion exercised by the person determining the interest rate (even within the allowed range) would carry a higher fair lending risk and should be monitored by the bank to ensure no discriminatory pattern results.

5. Question: With respect to the OCC's recent Order issued against a bank based on discrimination against white males and married couples, do banks need to continuously expand their assessment area?

   FLEX Chaloux noted that high-minority tracts just outside the bank's assessment area is a redlining risk. The FDIC expects FDIC-supervised banks to have objective and supportable reasons for the CRA Assessment Area or broader lending areas they define. There is no requirement to expand the CRA Assessment Area just to include census tracts because they are high-minority. However, the FDIC would look to the bank's overall lending patterns and if the bank were making loans to non-minority census tracts around or beyond the high-minority tracts, we would need to determine the reason for the gap in lending.

   The caller noted that many banks have indicated inconsistent examiner interpretations being applied during Fair Lending reviews.

   FLEX Chaloux noted the FDIC provides training to examiners and strives to achieve consistency within our exams throughout the country. RD Vogel noted that if a bank has a concern with examiner inconsistency or training, the bank should contact the Regional Office.

6. Question: Are there any additional examples other than the one provided on the call of expectations, or requirements, for collecting evidence to prove application of joint credit was intended, particularly for internet applications.

   FLEX Chaloux noted that the Federal Reserve Board (FRB) did not require a specific format or content when they addressed this issue within Regulation B's Official Staff Interpretations. The FRB did note that a Personal Financial Statement signed to attest the accuracy of the information would not be a reasonable indication of joint intent. Regulation B does indicate that whatever method a bank uses should be documented early in the application process and not at loan closing. If a customer clearly applies

jointly on a residential loan application this would be obvious on its face. For internet applications it might be possible to provide a check box or other affirmative assertion of joint intent for spouses who are not principles of the business, but still wish to be a joint applicant on the credit request. For more guidance on this issue please review Regulation B, the Official Staff Interpretations, Financial Institution Letter (FIL)-5-2004 and FIL 06-2004.

7. Question: Are there any specific expectations or "best practices" for regression analysis pertaining to risk assessments?

   FLEX Chaloux noted there are no specific expectations for use of regression analysis by banks as part of their self-assessments. The size, complexity, and volume of lending activity would be factors to consider in deciding if regression analysis is appropriate to the bank's risk profile. Many banks have a small universe of loans where regression analysis may not provide a reliable result. For low volume lenders, examiners often conduct comparative file reviews and use Excel to evaluate treatment of various products and customer groupings.

Questions received through Email after the call.

8. During the discussion of slide 11 on Spousal Signatures, Joe Chaloux pointed out that you can only ask for additional applicants or collateral if the initial applicant(s) do not qualify. Does that general sentiment apply to commercial lending, when the additional applicant may be a business partner or additional collateral may be commercially held property?

   Yes, the general sentiment applies to commercial lending. ECOA applies to all types of credit and there are no different standards between consumer and commercial loans. The bank should first see if the initial applicant qualifies for the loan. If the applicant does not qualify, the bank can then tell the applicant that a guarantee is needed in order to obtain the loan. Regarding collateral, if additional collateral (including commercially held property) is required, the bank can ask for security documents necessary under state law to reach that property. For more guidance on this please see FIL-5-2004.

   Would it be considered disparate treatment if application requirements were to be stratified based on industry empirical data regarding business risk, and/or historical approval rates for similar customers in the same industry, for a strictly commercial product?

   It is difficult to say for sure without specific facts and factors that are being included in the data you describe.

This has components that sound like a custom credit scoring model and if that is the case, we would point you to the guidance in Regulation B regarding such scoring models. More specific information to review when considering a credit scoring model can be found in the 2003 Federal Register which addressed several questions related to proposed and final changes to Regulation B (Volume 68, Number 52/March 18, 2003 – page 13162).

Does your answer to the last question change if sole proprietorships or "small businesses" where individual credit may be considered are included in the applicant pool?

I understand it may be difficult to opine with limited information, however, this is a hypothetical question at this time. I have found this to be a grey area with regards to whether or not this is consumer and how the regulations apply.

We don't think it would change simply because the individual borrowers' (or guarantor) credit histories were included. However, the data must be predictive of the likelihood of repayment by applicants in a given pool and it may not be appropriate to use the same factors for sole proprietorships or other "individual credit" if the predictive model factors are for larger business entities and non-persons. Some banks do use custom scoring models for consumer loans but the model is based off a dataset of loans from this product type and any factors used in evaluating applicants should be supportable as legitimate factors in predicting creditworthiness.

Remember, ECOA and Regulation B applies to <u>all types of credit</u> ***and there is no difference in standards between consumer and commercial loans.***

9. Regression analysis was briefly mentioned, specifically in regards to when regression analysis can be used when there is a sufficient amount of loan volume. Does the FDIC have any type of loan volume threshold as to when regression analysis should be used? We have recently purchased fair lending software that has regression analysis capabilities, but I don't believe our loan volume is enough to warrant regression analysis, but was looking for some more guidance. I don't recall seeing any specific guidance within the examination procedures, but if I'm incorrect, could you advise where I could find it?

We are not aware of any guidance that references thresholds for minimum numbers of loans to run a regression analysis.