Fair Lending For Financial Institutions

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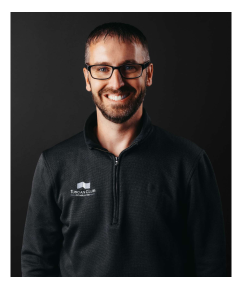
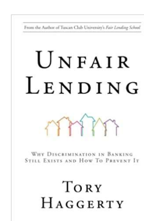
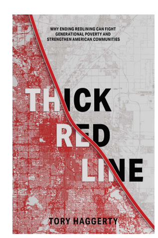
Tory Haggerty

- Worked in banking for 16 years
- Commissioned compliance examiner with FDIC
- Participated in over 450 exams and audits
- Authored the nation's only Fair Lending School for banking industry
- Besting-selling author
- Worked as internal auditor and compliance officer
- Retired officer in the South Dakota Air National Guard
- Married with 2 kids – Reside in Sioux Falls, South Dakota







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- Regulatory audit services
- Comprehensive fair lending reviews
- Examination prep
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What We Are Going To Talk About

- Fair Lending Laws – Prohibited Bases
- Three Types of Discrimination
- Regulatory Insight to Fair Lending
- Applications
- Steering
- Underwriting
- Pricing
- Exceptions
- Denials
- Redlining
- Marketing
- Lender's Responsibility

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

OFFICE OF THE COMPTROLLER OF THE CURRENCY

UNITED STATES FEDERAL RESERVE SYSTEM

cfpb
Consumer Financial Protection Bureau

NATIONAL CREDIT UNION ADMINISTRATION
NCUA
1934

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Quiz Question

True or False?

It is legal to discriminate against a loan applicant.

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Equal Credit Opportunity Act (ECOA)

Fair Housing Act (FHA)

Prohibited Bases

Laws Governing Fair Lending

ECOA

- Race
- Color
- Religion
- Sex - UPDATED
- National Origin
- Age
- Marital Status
- Source of Income – Public assistance
- Filing for protection under the Act

FHA

- Race
- Color
- Religion
- Sex
- National Origin
- Familial Status
- Handicap

EQUAL HOUSING LENDER

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Other Laws Connected To Fair Lending

Home Mortgage Disclosure Act (HMDA)

Community Reinvestment Act (CRA)

HMDA

- Collect data on home loan applicants
- Aggregate data analysis
- Redlining risk issues
- Steering risk
- Pricing risk

CRA

- Redlining
- Lending to all parts of assessment area
- Lending to all income levels
- CRA findings are public

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Types of Discrimination

Overt Discrimination

When a lender openly and blatantly discriminates on a prohibited basis

Disparate Treatment

Occurs when a lender treats an applicant differently based on one or more prohibited basis

Disparate Impact

A policy or practice that may be applied equally to all credit applicants, but the policy or practice has a disproportionate adverse impact on applicants from a group protected against discrimination

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Regulatory Insight

Examiners conduct a fair lending review at nearly every compliance examination (whether you know it or not)

Typical fair lending reviews include:

- ❑ Loan Policy
- ❑ Underwriting guidelines
- ❑ Pricing practices and rate sheets
- ❑ Exceptions
- ❑ Loan committee minutes
- ❑ Loan download

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Regulatory Insight

All reviews are risk focused

Areas covered could be:

- Pricing
- Underwriting
- Comparative file analysis
- Redlining
- Steering

Fair lending interview - What is the purpose?

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Loan Lifecycle of Risks

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What is an Application?

Application means an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested.

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Taking Applications

Internally developed applications vs. industry standard

Discouraging applications
- Loan Officer
- Teller
- Administrative assistant

Screening applications informally

Process must be consistent
- Going the "extra mile" for some applicants but not others

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Steering

Steering – The distinction between guiding consumers toward a specific product or feature; **Illegal steering** centers on whether the institution did so on a prohibited basis, rather than based on an applicant's needs or other legitimate factors.

Steering Indicators:

Lack of clear, objective and consistently implemented standards for referring applicants

Financial incentives for loan officers or brokers to place applicants in nontraditional products

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 or products with specific features relative to control group applicants

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Underwriting

Major Risk Factors:

Unclear underwriting standards

Loan officer deviations

Not tracking deviations

Ineffective or non-existent monitoring

Risk Mitigation:

Clearly written and understood underwriting standards

Deviations to policy are the "exception" not the "norm"

Secondary underwriting reviews

Part of your CMS monitoring

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Pricing

One of the greatest risks and easiest to track

Rate sheet – not only having one but using it

Consistency

Exceptions – Are you tracking AND what are you doing with the info? – more on that in a moment

Discretion should be controlled and monitored

Examples:

Across-the-board Consumer Pricing

Wild West Consumer Pricing

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Exceptions

Are loan officers allowed to make exceptions?

Underwriting, pricing, fees, and loan terms?

Are deviations from policy built into your program?

Do they require secondary approval?

Are you tracking exceptions?

If so, what are you doing with them

- Common banker response

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Denials

Consistent underwriting helps mitigate denial risk

Denial reasons – Be accurate

Comparative File Analysis

Adverse action notices

Secondary reviews

- Must be done on a fair basis

Consistency!

- Be careful if you go the extra mile for one customer and not another

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Marketing

This is where fair lending starts

What message are you sending to your customers?

Market to all areas & all customers – Redlining

Ads should be inclusive of population

Social Media – what is acceptable to post at your institution?

Can you be held accountable for what you post? 2 examples

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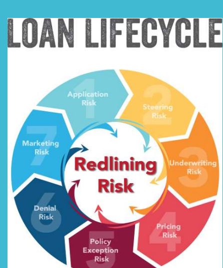
Redlining



Redlining - a form of illegal disparate treatment in which an institution 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 credit seeker resides or will reside or in which the residential property to be mortgaged is located.

<u>What does that mean?</u>

- an institution fails or refuses to extend credit in certain areas
- an institution targets certain borrowers or certain areas with less advantageous products
- an institution makes loans in such an area but at a restricted level or upon less-favorable terms or conditions as compared to contrasting areas; or
- an institution omits or excludes such an area from efforts to market residential loans or solicit customers for residential credit

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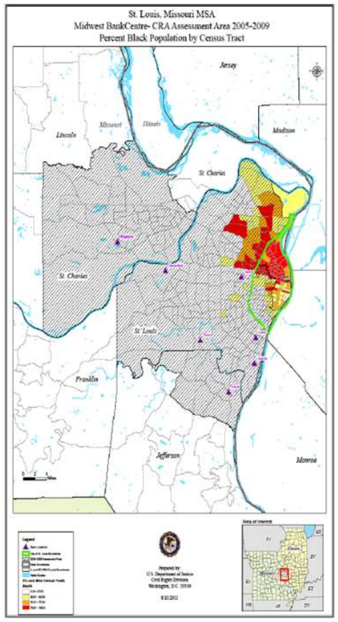
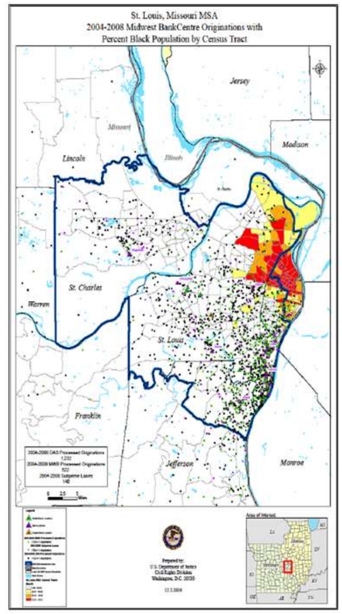
Redlining Examples

Midwest BankCentre





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Midwest BankCentre

By the Numbers

Lending in minority census tracts

2004

- MBC – 1.7% of loans; peers – 6.5% = **Ratio 3.8 / 1**

2005

- MBC – 1.4% of loans; peers – 7.8% = **Ratio 5.5 / 1**

2006

- MBC – 4.9% of loans; peers – 8.9% = **Ratio 1.8 / 1**

Applications in minority census tracts 2004 – 2008

- MBC – 2.7% of apps; peers – 10.7% = **Ratio 4 / 1**

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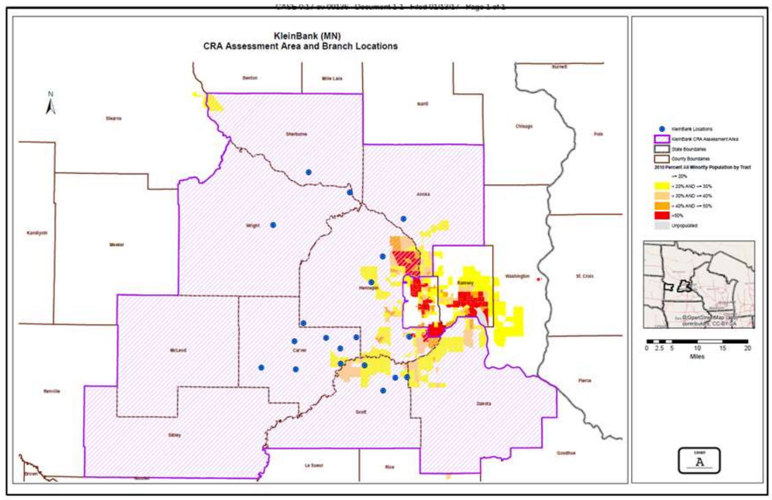
Redlining Examples

KleinBank



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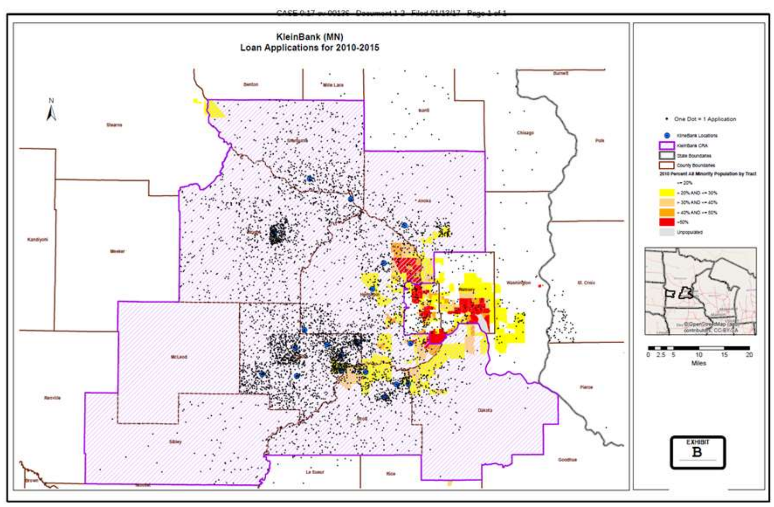
Redlining Examples

KleinBank



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KleinBank

By the Numbers

KleinBank
kleinbank.com

Lending in minority census tracts

2010 – 2015

- KleinBank – 1.2% of loans; peers – 5.2% = **Ratio 4.3 / 1**

Applications in minority census tracts

- KleinBank – 1.0% of apps; peers – 5.6% = **Ratio 5.6 / 1**

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The Classics

Having spouses sign the note when they didn't apply

Documenting joint intent – signing the bottom of the application or submitting a joint financial statement is not good enough

Requiring specific cosigners – you can require a cosigner, but you cannot state who it must be

Not grossing up non-taxable income

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Lender's Responsibility

- Always use bank approved applications
- Don't go the extra mile for one applicant and not another
- Follow bank underwriting and pricing guidelines
- Get proper approval for any deviations from policy
- Understand the prohibited bases
- Understand your role in mitigating the fair lending risk to your institution
- Follow your institution's social media guidelines and be responsible

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Questions

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