Fair Lending: Examiner Expectation for Your Fair Lending Program

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Your Speakers

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Agenda

- Basic fair lending requirements
- From the regulators
- Fair lending program
- Fair lending analysis

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Fair Lending Regulations

- Regulation B – Equal Credit Opportunity Act (ECOA), 1974
- Fair Housing Act (FHA), 1968

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Covered Aspects

ECOA

- Taking applications
- Evaluating applications
- Extending credit
- Credit admin and servicing
- Collection activities

FHA

- Loans to buy, build, repair, improve dwelling
- Purchase or rental of residential dwellings
- Selling, brokering, appraising

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Prohibited Basis Groups

- Illegal to discriminate on the basis of:
  - ECOA and FHA:
    - Race or color
    - Religion
    - National origin
    - Sex
  - ECOA only:
    - Marital status
    - Age
    - Receipt of income from public assistance programs
    - Exercise of rights under Consumer Credit Protection Act
  - FHA only:
    - Familial status—children, pregnant
    - Handicap

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Fair Lending

Overt discrimination

- Openly discriminates on a prohibited basis
- Explicitly considers prohibited factors
  - Will not lend to those over the age of 55
  - Rate 18% for females and 12% for males

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Fair Lending

Disparate treatment – Can be overt or subtle disparities

- Differences in treatment that are not explained by legitimate nondiscriminatory factors
  - Approving white applicant and denying similarly situated Asian applicant
  - Working with white applicant to explain credit issues and moving directly to denial on African-American applicant
  - Redlining

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Fair Lending

- Disparate impact
  - Neutral policy or practice applied evenly to all applicants that disproportionately excludes or burdens a prohibited basis group
  - Disparity by itself is not evidence of discrimination
  - Policy must be justified by a business necessity
  - No other policy or practice could serve the same purpose with a less discriminatory effect
  - Discriminatory intent is not required

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Fair Lending

- Examples of disparate impact
  - Minimum loan amounts
  - Collateral restrictions
  - Minimum income limits
  - Pricing discretion
  - Not grossing up nontaxable income

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Discrimination Can Occur at Any Phase of the Credit Transaction

- Inquiry or application
- Evaluation of the application
- Making the credit decision
- Notification of the applicant of approval or denial
- Closing of the loan
- Servicing of the loan
- Collection or foreclosure

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Discouragement

Discouragement. A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application.

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Methods of Discrimination

- Appraisal that says neighborhood shows "pride of ownership"
- Requiring spousal co-signer
- Requiring spousal income even though applicant has not asked you to
- Ignoring co-applicant income for nonmarried applicants

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Methods of Discrimination?

- Offering special credit discounts to individuals 55-61 years of age
- Offering different credit card limits based on age of applicant
- “We don’t like to make home mortgage loans to Native Americans, but the law says we cannot discriminate, and we have to comply with the law.”

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Collecting Information on Spouses

- A creditor may not request any information concerning the spouse or former spouse of an applicant except as stated below:
  - The spouse will be permitted to use the account
  - The spouse will be contractually liable on the account
  - The applicant is relying on the spouse's income as a basis for repayment of the credit requested
  - The applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested

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Collecting Information on Spouses

- The applicant is relying on alimony, child support, or separate maintenance payments from a spouse or former spouse as a basis for repayment of the credit requested

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Residency

- A creditor may inquire about the permanent residency and immigration status of an applicant or any other person in connection with a credit transaction

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Are You Married?

- Individual unsecured credit – Creditor shall not inquire about the applicant's marital status unless the applicant resides in a community property state or is relying on property located in such a state as a basis for repayment of the credit requested.
- Other types of credit – Creditor may inquire about the applicant's marital status but shall use only the terms *married, unmarried,* and *separated.* A creditor may explain that the category *unmarried* includes single, divorced, and widowed persons.

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Are You Still Married?

- *Disclosure about income from alimony, child support, or separate maintenance.* A creditor shall not inquire whether income stated in an application is derived from alimony, child support, or separate maintenance payments unless the creditor discloses to the applicant that such income need not be revealed if the applicant does not want the creditor to consider it in determining the applicant's creditworthiness.

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Do You Have Children?

- *Childbearing, childrearing.* A creditor shall not inquire about birth control practices, intentions concerning the bearing or rearing of children, or capability to bear children. A creditor may inquire about the number and ages of an applicant's dependents or about dependent-related financial obligations or expenditures, provided such information is requested without regard to sex, marital status, or any other prohibited basis.

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Inquiries

- Creditor cannot ask about race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction, unless conducting a self-test or the transaction is a purchase or refinance of a principal dwelling or a HMDA-reportable loan for a HMDA reporter.
- Can ask for titles if optional: Mr., Mrs., Ms., Miss

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Collecting Demographic Data

- Creditors must request demographic information when they receive an application to purchase or refinance the purchase of a loan secured by a one- to four-family dwelling that is a principal residence. The following should be requested:
  - Age
  - Race
  - Ethnicity
  - Gender
  - Marital status

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Collecting Demographic Data

- Exceptions
  - Temporary financing and initial construction loans

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Collecting Demographic Data

- The creditor shall inform the applicant(s) that the information is being requested by the federal government for the purpose of monitoring compliance with federal statutes that prohibit creditors from discriminating against applicants on those bases. The creditor shall also inform the applicant(s) that if the applicant(s) chooses not to provide the information, the creditor is required to note the ethnicity, race, and sex on the basis of visual observation or surname.

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New Revisions to Regulation B

- Besides collecting ethnicity, race, and sex information for HMDA-reportable loans or loans to purchase or refinance a principal dwelling, it is permissible to collect this data if:
  - The HMDA reporter is not required to collect close-end mortgage loan data but optionally reports it or did report it in the previous five years.
  - The HMDA reporter is not required to collect open-end mortgage loan data but optionally reports it or did report it in the previous five years.

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New Revisions to Regulation B

- Demographic data collections allowed (continued):
  - Not currently a HMDA reporter but was a HMDA reporter in the prior five years and exceeded threshold last year for closed-end or open-end lines of credit; can collect it the following year.
  - Currently a HMDA reporter or was one in the prior five calendar years; can collect data on any dwelling-secured, business-purpose loan.
  - If collecting demographic data, as allowed, can collect on all co-applicants.

Evaluating Credit Applications

- Cannot consider age other than that the applicant is old enough to contract
  - Can use credit scoring models, empirically derived, demonstrably and statistically sound; can use age as predictive variable but cannot assign a negative factor for the elderly
  - A creditor may consider the adequacy of any collateral offered when the term of the credit extension exceeds the life expectancy of the applicant and when the cost of realizing on the collateral could exceed the applicant's equity

Evaluating Credit Applications

  - An elderly applicant might not qualify for a five-percent down, 30-year mortgage loan but might qualify with a larger down payment or a shorter loan maturity
- Cannot make assumptions or use statistics to determine a category of person being more likely to bear children and receive diminished income
- Cannot consider whether there is a telephone in the applicant's name but can require that there be one in the household

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Evaluating Credit Applications

- Cannot discount income because it is part-time or because it is retirement income, alimony, or child support but can determine the likelihood that it will continue
- Must consider the accounts the applicant is contractually liable on or permitted to use
- Consider any information the applicant provides stating the credit history is not accurate
- At applicant's request, accounts of spouse or former spouse that the applicant demonstrates reflects their creditworthiness

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Evaluating Credit Applications

- Must evaluate married and unmarried applicants by the same standards
- When considering income derived from a public assistance program, a creditor may take into account, for example:
  - The length of time an applicant will likely remain eligible to receive such income
  - Whether the applicant will continue to qualify for benefits based on the status of the applicant's dependents (as in the case of Temporary Aid to Needy Families or social security payments to a minor)

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Evaluating Credit Applications

  - Whether the creditor can attach or garnish the income to ensure payment of the debt in the event of default

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Extending Credit

- Open-end credit – Cannot require reapplication, change the terms, or terminate the account because the borrower is a certain age, retiring, divorcing, or otherwise changing name or marital status unless the creditor has evidence the borrower will be unwilling or unable to pay on the account
  - If divorcing and credit was established based on income of spouse, can require reapplication if it appears remaining income would not sustain the current credit line

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Extending Credit

- Cannot require the signature of a spouse or other person unless applying for joint credit; signing an application or personal financial statement to attest the accuracy is not considered applying for joint credit
- Can request co-signer or guarantor if the applicant is not creditworthy on their own, but cannot request that the co-signer or guarantor be the applicant's spouse

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Extending Credit

- A creditor may require the personal guarantee of the partners, directors, or officers of a business and the shareholders of a closely held corporation, even if the business or corporation is creditworthy
- A creditor shall not refuse to extend credit and shall not terminate an account because credit life, health, accident, disability, or other credit-related insurance is not available on the basis of the applicant's age

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Interagency Joint Policy Statement

1994 Interagency Joint Policy Statement Fair Lending – A lender may not, because of a prohibited factor:

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards;
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit;
- Refuse to extend credit or use different standards in determining whether to extend credit;
- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan;
- Use different standards to evaluate collateral;

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Interagency Joint Policy Statement

- Treat a borrower differently in servicing a loan or invoking default remedies; or
- Use different standards for pooling or packaging a loan in the secondary market.
- A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis.
- A lender may not discriminate on a prohibited basis because of the characteristics of:
  - A person associated with a credit applicant (for example, a co-applicant, spouse, business partner, or live-in aide); or
  - The present or prospective occupants of the area where property to be financed is located.

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Interagency Joint Policy Statement

- Make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.
- HMDA data alone does not prove discrimination because it is missing key information such as credit histories and debt ratios.
- Disparate impact – When a lender applies a policy or practice equally to credit applicants, but the policy or practice has a disproportionate adverse impact on applicants from a group protected against discrimination, the policy or practice is described as having a "disparate impact." Policies and practices that are neutral on their face and that are applied equally may still, on a prohibited basis, disproportionately and adversely affect a person's access to credit.

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Interagency Joint Policy Statement

  - Disparate impact is not established by mere perception or general assertion; it must be established by facts.
  - Policy or practice must be justified by a business necessity with no less discriminatory alternative.
- Example: A lender's policy is not to extend loans for single-family residences for less than $60,000. This policy has been in effect for 10 years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live. The lender will be required to justify the "business necessity" for the policy.

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Interagency Joint Policy Statement

Example: In the past, lenders primarily considered net income in making underwriting decisions. In recent years, the trend has been to consider gross income. A lender decided to switch its practices to consider gross income rather than net income. However, in calculating gross income, the lender did not distinguish between taxable and nontaxable income even though nontaxable income is of more value than the equivalent amount of taxable income. The lender's policy may have a disparate impact on individuals with disabilities and the elderly, both of whom are more likely than the general applicant pool to receive substantial nontaxable income. The lender's policy is likely to be proven discriminatory. First, the lender is unlikely to be able to show that the policy is compelled by business necessity. Second, even if the lender could show business necessity, the lender could achieve the same purpose with less discriminatory effect by “grossing up" nontaxable income (i.e., making it equivalent to gross taxable income by using formulas related to the applicant's tax bracket).

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BCFP – Fair Lending Report

- December 2018
  - Mortgage lending priority…focusing on redlining, underwriting, pricing, steering, servicing and HMDA data integrity
  - In 2017, enforcement addressing discrimination in credit card terms and conditions and supervisory activity in student loan servicing and small business lending

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BCFP – Fair Lending Report

- December 2018 (Cont.)
  - Most cited exam violations
    - Discrimination on a prohibited basis in a credit transaction
    - Improperly inquiring or not inquiring about demographic information
    - Improperly requiring the signature of a spouse
    - Failure to provide notice of a credit decision in 30 days
    - Failure to keep records of action on incomplete apps

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BCFP – Fair Lending Report

- December 2018 (Cont.)
  - Most cited exam violations
    - Failure to provide appraisals to applicants

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BCFP – Fair Lending Report

- DOJ Referrals – 11 referrals on ECOA matters from all agencies combined.

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HUD’s Final Rule

- June 2018 – HUD issues request for comment regarding the 2013 final rule below in light of Community Affairs v. Inclusive Communities Project Inc. Docket Number FR-6111-A-01
  - HUD seeks to clarify, decrease burden and assist in determining what is lawful

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HUD's Final Rule

- February 15, 2013, HUD issued final rule specifying standards for proving a discriminatory effects violation, effective March 18, 2013
  - HUD is responsible for interpreting and enforcing Fair Housing Act and has power to make rules to implement the act.
  - The Act did not provide a standard for proving discriminatory effect.
  - The 2013 rule provides for a three-part burden-shifting test.

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HUD's Final Rule

- First, the plaintiff has to bear the burden of proving sufficient evidence that a practice results in or would predictably result in a discriminatory effect on the basis of a protected class
- Second, if the plaintiff is successful, the defendant has the burden to prove that the challenged practice is necessary to achieve one or more of its substantial, legitimate, nondiscriminatory interests (business necessity)
- Third, if the defendant is successful, then the plaintiff would have to prove there was another, less discriminatory practice that could have serviced this business necessity

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HUD's Final Rule

- A business necessity must be supported by evidence and may not be hypothetical or speculative

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HUD's Final Rule

- *Texas Department of Housing & Community Affairs v. The Inclusive Communities Project, Inc.*
  A community organization challenged a state housing agency's allocation of low-income housing tax credits in the Dallas area, claiming that the allocation of more credits in predominantly minority neighborhoods than in predominantly Caucasian neighborhoods perpetuated racial segregation and constituted illegal disparate impact in violation of the FHA

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HUD's Final Rule

- On June 25, 2015, the Supreme Court, by a five-to-four margin, upheld the application of disparate impact under the FHA in *Texas Department of Housing & Community Affairs v. The Inclusive Communities Project, Inc.* While upholding the theory, the Court imposed significant limitations on its application in practice.
- To protect potential defendants against abusive disparate-impact claims, the Court held that a racial imbalance, without more, cannot sustain a claim and directed lower courts to "examine with care" the claims at the pleadings stage.
- Cases must establish a robust causal connection between the challenged practice and the disparity.
- A business necessity, as long as it's not artificial, arbitrary, or unnecessary, would not be considered contrary to the disparate impact requirement.

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HUD's Final Rule

- The Court wanted to avoid the use of numerical quotas that could result from attempts to avoid disparate-impact claims.
- Statistical disparities alone, without a link to a policy causing the disparity, should not result in claims.
- When finding disparate impact has occurred, remediation should focus on creating racially neutral practices rather than punitive sanctions and penalties.
- The Court stated that businesses need to be free to make practical business choices and profit-related decisions that sustain a vibrant and dynamic free enterprise system.

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CFPB Bulletin

- CFPB Bulletin 2014-03 – Social Security Disability Income Verification
  - The CFPB stated that verification of the length of public assistance benefits beyond what the agencies and secondary market require may result in fair lending concerns under Regulation B and ECOA. In addition, the CFPB referenced the disparate-impact doctrine regarding a practice that appears neutral on its face and results in a disproportionately adverse effect on a prohibited basis group, even though the creditor had no intent to discriminate, unless the creditor has a legitimate business need that could not be met in a manner that was less discriminatory.

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Enforcement

- Consent Order
  - Union Savings Bank and Guardian Savings Bank in Ohio – $9 million settlement. From 2010 until 2014, the banks served the credit needs of predominantly white neighborhoods to a greater degree than majority African-American neighborhoods.
    - Branches located to avoid lending in these areas
    - Incenting lenders to avoid these areas
    - Not effectively marketing in these areas

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Enforcement

- HUD and Bank of America
  - –Testers sent to one South Carolina branch
  - –Hispanic and non-Hispanic
  - –Disparate treatment in the preapplication process
  - –Same employees greeted each tester

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Enforcement

- Enforcement
  - Klein Bank and DOJ (in litigation)
    - –A pattern or practice of unlawful redlining by structuring its residential mortgage lending business so as to avoid serving the credit needs of neighborhoods where a majority of residents are individuals of racial and ethnic minorities
    - –Minneapolis-St. Paul-Bloomington, MN-WI Metropolitan Statistical Area (MSA)

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Enforcement

- Enforcement
  - Klein Bank (continued)
    - All branches have been located in majority-white census tracts
    - None of the residential mortgage loan officers maintain offices in majority-minority census tracts
    - Engaged in limited marketing outside its CRA assessment area and failed to advertise meaningfully in majority-minority neighborhoods
    - Klein Bank settled the case ($300k in loan subsidy fund and $300k in advertising outreach)

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Enforcement

- Enforcement
  - HUD and Wescom Federal Credit Union – Pasadena, CA
    - Denied loan because of maternity leave
    - The credit union required the wife to return to work and provide a current paystub before the couple would be granted a loan
    - Must set up a $50,000 compensation fund for similar applicants who were denied and approve the couple's loan at a lower interest rate

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Enforcement

- American Express Centurion Bank and American Express Bank – August 2017
  - Inferior credit card terms for those in Puerto Rico, U.S. Virgin Islands and other U.S. territories to those in U.S.
  - Restricting collection offers to those with Spanish language preference

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Enforcement

- HUD and LoanDepot.com, LLC and Appraisal Management Services of America, Inc. – August 2018 – $240,000 - closed loan applications because properties were located on an Native American Reservation, could not provide appraisal because property was on Indian land.

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Fair Lending Program

- What does your fair lending program look like?

Risk Assessment	
Products and services	Marketing practices
Geography	Access to credit
Pricing and fees	Compensation
Underwriting	Servicing and collections
Complaints	Third parties

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Fair Lending Risk Assessment

Demographics and Market

The FI operates from 10 branches in central Wisconsin. The majority of the Bank's assessment area is in rural agricultural communities. The Bank's assessment area consists of XX county and portions of XX county. The census tracts within the assessment area consist of 5 high minority tracts as follow: X, X, X, X, and X. The assessment area is __% minority. No high minority tracts adjacent to the assessment area.

Quantity of Risks			
Demographics and Market			
Low	***Moderate***	***High***	***Risk Assessed***
Assessment area and adjacent areas do not include high minority or low or moderate income demographics.	Assessment area and adjacent areas have a few high minority or low or moderate income demographics.	Assessment area and adjacent areas primarily consists of high minority and low or moderate income demographics.	**Moderate**

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Fair Lending Program

- Policies and procedures
  - Policy statement prohibiting discrimination based on prohibited basis groups in Regulation B and FHA
  - Clear, objective underwriting standards for each type of credit (LTV, DTI, credit scores, etc.; nontaxable income; disability/maternity leave; credit scoring system guidelines; married vs. unmarried DTI)
  - Guidance on pricing – Limitations on discretion, risk-based pricing criteria, credit report fees

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Fair Lending Program

- Policies and procedures
  - Handling of exceptions to policy and approval process
  - No age restrictions other than legal age to contract
  - No overt discriminatory language
  - Business case for any policies that could result in disparate impact: minimum income, minimum loan amounts, collateral restrictions
  - Oversight of third-party brokers or loan originators or servicers

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Fair Lending Program

- Servicing and collection standards
  - Prompt crediting of payments
  - Requirements for escrow and cancelling escrow
  - Procedures for payoffs and releasing collateral
  - PMI requirements
  - Objective, precise collection steps
  - Standard practices for offering loss mitigation options

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Fair Lending Program

- Marketing
  - Marketing addresses full lending area
  - Targeted marketing does not include discriminatory criteria
  - Targeted marketing does not exclude certain geographies without defendable business case
  - Undesirable products are not targeted to certain geographies

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Fair Lending Program

- Complaint management
  - Good process to review and address complaints
  - Complaints are also sent to managers, senior management and compliance and Board
  - Complaints are responded to in a timely manner
  - They are looked at from a fair lending perspective

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Fair Lending Program

- Oversight of third parties
  - Brokers, LPOs, servicers, collectors
    - –Policies
    - –Training
    - –Oversight
    - –Monitoring
    - –Contracts

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Fair Lending Program

- Training
  - Everyone who might have contact with a customer from application to payoff
  - Greeters, personal bankers, lenders, processors, underwriters, servicers, collectors
  - Testers

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Fair Lending Program

- Risk indicators
  - Disparities among approval/denial rates
  - Disparities in application processing times
  - Disparities in geographic dispersion of loans
  - Disparities in applications received as compared to demographic make-up
  - Disparities in product offerings among prohibited basis groups
  - Redlining risk

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Policy Monitoring

- Restrictions on collateral that may be more likely to be owned by a prohibited basis group
- Underwriting criteria that requires a certain level of income, such as $10,000 annual income required to obtain a credit card
- Rate sheets with a range of rates (i.e., unsecured 10%-12%)
- Underwriting criteria that look at age or retirement income less favorably or at income rather than debt to income or residual income, etc.

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Policy Monitoring

- Policy on lending to women on maternity leave or other form of disability
- What is required to be obtained for those on disability?
  - No more stringent than secondary market standards (SSN awards letter, intent to return to work if on maternity leave, confirmation from employer that it will take the employee back at work)

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Redlining

- Monitoring
  - Plot assessment area and contingent tracts shaded by percentage of minorities
  - Plot origination of loans within the assessment area and contingent areas – look for gaps
  - Availability of products and services and differences in offerings or hours of service in high-minority areas

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Monitoring

- Monitoring
  - Marketing review to determine whether high-minority areas receive the same level of marketing – Where does each publication reach, and which products are targeted? Prescreen list – determine criteria and if any criteria could be discriminatory.

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Monitoring

- Consider your branching practices over the last several years. Have you surrounded but avoided certain areas? Is there a geography that makes sense for you to lend in, but it appears to be avoided? Is it high-minority/low-income? To determine lending area: Where do you market? Where do you hire LOs? Where do you lend or should you lend?
- Understand your competition. Are there reasons you cannot generate loan volume in certain areas?

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Steering

- Monitoring
  - Consider compensation of lenders and loan production staff – Any incentive to steer to certain products or avoid others
  - Review product mix by protected class to determine reasonableness (i.e., percentage of blacks/African-Americans with FHA loans vs. other types as compared to whites with FHA loans vs. other types)
  - Where are your LPOs and brokers? Is there a focus in certain geographical areas?

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Other Monitoring

- Monitoring
  - Pricing
    - Look at how each product is priced, view rate sheets for any discriminatory criteria. How are small business loans priced? Can a third party price loans? When can fees be waived. If risk-based pricing, look at criteria.
  - Underwriting
    - Look at how each product is underwritten. Are there objective criteria for each? Auto decision tool – look at criteria. Does criteria vary for the same product by delivery channel (i.e., some require verifications, some do not)?

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Other Monitoring

- Monitoring
  - Exception reports – Review exception reports to determine whether exceptions to policy appear to be given to certain groups more than others, look for trends, what types of exceptions are made, who is reviewing these reports, and whether changes are made to processes and procedures based on results.

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Other Monitoring

- Monitoring
  - Are collection efforts consistent between all past due borrowers? Are loss mitigation options offered to all? Assistance offered to all? Look at past due reports and collection files, proxy and determine whether it appears all are treated the same.
  - Consider make-up of foreclosed borrowers and whether more are from prohibited basis groups.

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Other Monitoring

- Monitoring
  - Complaints – Analyze logs for trends, any heightened fair lending risk, look on CFPB website, social media, trends – certain lenders, products, from certain protected class, certain topic.
  - Interviews – Interview everyone that might come into contact with a loan applicant and determine whether they understand fair lending risk.
  - Third parties – Conduct ongoing due diligence, review complaints, obtain documentation of training, monitor activity, verify contracts cover services and liability.

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Data Analysis

- Disparity ratios – The disparity ratio will tell you the rate at which the protected class is denied in relation to its control group. For example, assume that out of 20 Asian applicants (your protected class), 10 were denied. That equates to a 50% rate of denial. Now when looking at white applicants (your control group), you see that out of 40 applicants, 12 were denied, equating to a 30% rate of denial. To calculate the disparity ratio, take the rate of denial for Asian applicants (50%) and divide it by the rate of denial for white applicants (30%). The resulting disparity ratio of 1.67 means that, at face value, Asian applicants were 1.67 times more likely to be denied than white applicants.

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Data Analysis

- Disparity ratios (continued)
  - While there are no established criteria, a generally accepted standard is that any disparity ratio of 1.50 or greater constitutes a disparity ratio worthy of additional research.

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Data Analysis

- T-test percentages assess whether the means of two groups are statistically different from each other.
- Regression analysis – Statistical process for estimating the relationship among variables.

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Pricing Analysis Based on Age

Pricing analysis based on age	
Conventional =	Target group DTI <=control group DTI
Cash out refinance =	Target group CLTV <=control group
Units =	Target group credit score >=control
Application dates within 15 days	Credit scoring model =
Loan term =	Lien status =
Not business purpose	Site built =
Not a line of credit Principal residence =	Target group interest rate >control group interest rate
Not a reverse mortgage No interest-only payments	Or, target group origination charges >control
No balloon payments No negative amortization	Target group discount points >=control group
Target group =>62	Introductory rate = NA
Control group <62	Application Channel = direct

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Underwriting Analysis Based on Ethnicity

Conventional =	Target group = denied
Purchase =	Control group = approved
Units =	Target group DTI <=control group DTI
Principal residence =	Target group CLTV <=control group
Loan term =	Target group credit score >=control
Not business purpose	Credit scoring model =
Not a line of credit	Lien status =
Not a reverse mortgage	Site built =
Principal residence =	Target group reason for denial
Target group = Hispanic	AUS system =
Control group = Not Hispanic	AUS system results =
No balloon payments, interest only, or negative amortization	

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Comparative File Analysis Example Underwriting Ethnicity

Field	Target	Control
Action Date	12/21/2016	11/28/2016
Action Type	3 - Denied	1 - Originated
Denial Reason 1	4 - Insufficient collateral	
Denial Reason 2		
Denial Reason 3		
DTI Ratio (Combined)	31.346	34.769
Ethnicity (Applicant)	1 - Hispanic or Latino	2 - Not Hispanic or Latino
Ethnicity (Co-Applicant)	5 - No Co-Applicant	5 - No Co-Applicant
FICO (Combined)	689	703
HOEPA Status	2 - Not a HOEPA loan	2 - Not a HOEPA loan
Lien Status	1 - First Lien	1 - First Lien
Loan Amount	111,000	108,000
Loan Product	CONVENTIONAL FI	CONVENTIONAL FI
Loan Purpose	1 - Home purchase	1 - Home purchase
Loan Term (Months)	360	360
Loan Type	1 - Conventional	1 - Conventional
LTV Ratio	100	98.298
Marital Status (Applicant)	1 - Single	3 - Divorced

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Comparative File Analysis

Owner-Occupancy	1 - Owner-occupied	1 - Owner-occupied
Preapproval	2 - Preapproval Not Requested	2 - Preapproval Not Requested
Property Type	1 - One to Four Family	1 - One to Four Family
Purchaser Type	0 - Loan not originated or sold in report year	6 - Commercial/savings bank or savings
Race (Combined)	5 - White	5 - White
Race 1 (Applicant)	5 - White	5 - White
Race 1 (Co-Applicant)	8 - No Co-Applicant	8 - No Co-Applicant
Rate Lock Date		
Rate Spread (Official)		1.265
Sex (Applicant)	1 - Male	2 - Female
Sex (Co-Applicant)	5 - No co-applicant	5 - No co-applicant
Sex (Combined)	1 - Male	2 - Female
Total Income	64,000	59,000

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Analysis

- Processing times – Action taken date to application date difference; sort by AUS system used or not used, purchaser code, loan type and purpose, number of units, demographic information, credit scores, etc.
- Comparative file analysis – Once disparities are identified, pull files from control and target groups electronically or manually, and match up similarly or better-situated target group applicants with control group applicants to see whether any true matched pairs exist in underwriting or pricing.

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Analysis

- Disparities from certain lending channels as compared to other application channels.
- Gaps in lending patterns – Plot loans in lending area and determine whether there are areas where loans are not being originated or very few are originated – high minority areas? Differences in products by branch, by loan officer, broker?
- Plot branch locations and look for any patterns in branching that may appear to be redlining.

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Analysis

- Are there disparities related to certain NMLS numbers? You can better determine whether certain loan officers' loans contain more disparities.
- Disparities in withdrawn/incomplete applications
- HMDA data vs. assessment area demographics
  - Assessment area is 52% Hispanic; however, only 13% of applications and 5% of originations on the LAR are from Hispanics.
  - Consider reasons for disparities, such as number of owner-occupied residences in those areas, number of one- to four-family residences, unemployment %, other mitigating factors.

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Summary

- If your institution makes loans, you have fair lending risk.
- A sound program to oversee this risk is fundamental to any CMS program.
- Your program should include a risk assessment, policies and procedures, training, monitoring/auditing, data analysis, and senior management and board oversight.
- Your institution should also adjust the program as risks change.

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Questions?

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Fair Lending: Examiner Expectations for Your Fair Lending Program
Webinar Questions and Answers

1. **For disparate impact with regard to minimum loan amounts, what about real estate loans when it comes to HPML and QM requirements where regulations prohibit or make it difficult for lenders to do lower loan amounts? Is this disparate treatment if we say as an organization we won't do non-QM loans?**

   No, disparate treatment would be treating people differently because they are in a protected class. If you mean disparate impact, as you stated in your first sentence, possibly. If you have a policy to not originate non-QM loans and you analyze the effect of the policy and determine that the policy has had a negative effect on one or more protected groups, this could result in disparate impact, in which case you'd need to demonstrate a business need that caused you to need this policy. The first step would be to determine whether you think there has been a detrimental effect. If not, there would not be any disparate impact.

2. **Can you please touch on concerns with loan programs for doctors, attorneys, or other professionals and what should be done to monitor for potential disparate impact?**

   We look at those only because they tend to provide more favorable terms. Profession is not a protected class, so the programs are generally not an issue, as long as the people receiving these loans are from different ethnicities, races, and genders. I'd periodically look at the recipients of these loans and verify you are seeing some diversity.

3. **Are we required to ask for spousal information and income when doing a loan in a community property state or is it per lender's discretion?**

   In general, you have to look at your individual state law to determine whether you are required to ask for the information. In Wisconsin, in general terms, you are required to consider all marital property. Along with that, you should also look at total marital debt. From a high level and in the absence of a marital property agreement, each spouse can have a 50% claim on wage income. So in simple terms, you would look at the total marital income and total marital debt. Please be aware that this is not a legal opinion, and you should seek legal counsel for definitive answer.

   History: 1985 a. 37.

   766.56 **766.56 Credit transactions with married persons.**

   766.56(1)**(1)** If a spouse applies for credit that will result in an obligation described under s. 766.55 (2) (b), the creditor, in evaluating the spouse's creditworthiness, shall consider all marital property available under s. 766.55 (2) (b) to satisfy the obligation in the same manner that the creditor, in evaluating the creditworthiness of an unmarried credit applicant, considers the property of an unmarried credit applicant available to satisfy the obligation.

4. **If a bank does not report HELOCs for HMDA, are we required to collect demographics?**

   Only if the HELOC is to purchase or refinance the purchase of a primary dwelling.

   > *Transactions not covered. The information-collection requirements of this section apply to applications for credit primarily for the purchase or refinancing of a dwelling that is or will become the applicant's principal residence. Therefore, applications for credit secured by the applicant's principal residence but made primarily for a purpose other than the purchase or refinancing of the*

principal residence (such as loans for home improvement and debt consolidation) are not subject to the information-collection requirements.

An application for an open-end home equity line of credit is not subject to this section unless it is readily apparent to the creditor when the application is taken that the primary purpose of the line is for the purchase or refinancing of a principal dwelling.

5. **If we do a temporary loan that is to refinance their current home loan plus new money for home improvements, my understanding is we would collect GMI for the refinance part of that transaction under Reg B?**

   Yes, it would be collected; the only temporary financing exception in Regulation B is for construction loans for initial construction.

6. **Will this webinar be provided as a recorded webinar? I am a Compliance Officer, and I think this would be excellent training for the bank's lending staff to listen to as annual training. Not all of our lending staff can listen to a webinar at the same time, and we have 8 different locations that provide lending services.**

   Yes, the webinar will be posted on our website at www.wipfli.com/insights. Click on the recorded webinars in the left column.

7. **If loan is being denied and no Loan Estimate is being issued because of denial in 3 days, are we still required to provide appraisal notice?**

   Yes, the appraisal notice is required on all applications for loans to be secured by a first lien on a one- to four-family dwelling. You would need to provide a separate appraisal notice if the LE is not sent.

8. **Is there anywhere in the regulation regarding the required timing for an internal audit of Fair Lending? Annually? Or, is it risk-based?**

   There is no required internal audit of fair lending, but it would be part of a good fair lending program. It can be risk based. Fair lending generally is higher risk, so you most likely would want to do something annually, but you could rotate the content of the audit between years.

9. **For social media advertising/marketing, what is your take on the use of Household Income, Age, or Racial makeups. This is common for social media, and we tend to get push back from marketing when asked not to use PHGs?**

   If you are marketing lending products, unless you can support a reason to target a certain group with the product, it may be seen as discriminatory and a form of redlining or discouragement. Facebook recently was criticized for allowing vendors to do this, so I would suspect it will be something the examiners will start to look for, although it usually takes them a little longer to catch up.

10. **Many lenders don't do manufactured home loans due to the tendency to depreciate. Is this discriminatory? If a lender offers, would it be discriminatory to have a rate higher than a conventional home loan across all credit score tiers?**

    This would be one of those neutral policies that may have a bigger negative impact on one group over another resulting in disparate impact. The first step is to determine whether a protected class would be or could be negatively impacted by the policy. If so, the next step is to have some actual quantifiable support for the fact that they depreciate too much to be reliable collateral (support for your business need). You would also want to see if there is anything else you could do to meet your business need (have good collateral) and still make loans to the protected class that is affected, such as requiring a lower LTV. Having a higher rate may be supported if you have a business case justification such as the risk of the collateral value not being as high. That seems to be a common practice on those loans.

11. **When doing matched pairs for pricing or underwriting, what is the best way to go about it as we have 18 different investors. As far as pricing, for the most part it is set by the investor; however, underwriting we are delegated for some investors and non-delegated to underwrite for others. We currently use a software but want to ensure we are performing to the best of our ability.**

    I'd first start by doing a disparity analysis by investor. Sort out loan type, purpose, lien status, and investor for pricing. You may also want to sort by loan term. Then determine the rate of denial by prohibited basis group and the average APR and calculate a disparity ratio. For those with no disparities, you would not need to do a comparative file review or further analyze for matched pairs.

    If you have some investors that show a disparity in pricing or underwriting for a certain loan type and prohibited basis group, I'd only pull files or further analyze electronically the ones with disparities. If doing manually, I'd pull all the files for the target group and a representative number of files for the control group (you can use the interagency fair lending procedures for sampling methodology) and tie them to the applicable rate sheet and criteria for pricing (LLPAs) and as long as they meet all the criteria for that time period's rate sheet and received that rate, you'd document this. If you have any that were exceptions, you would need to find out why and see if they are making exceptions for everyone or just one group. See if any others had that same exception reason but weren't given a lower rate.

    For underwriting, you'd want to pull the target and control group files from the investor for the product that had the disparity and list out all the underwriting criteria considered for that loan type. You'd want to do this on the approvals and the denials. You'd document why each of the denials were denied, and then you'd check all of the approvals to see if any of them had the same factor that was denied in the other files. If so, you'd have a matched pair. If data is available, this can all be done quickly with software.

    We can do all of this for you electronically. Just give us a call.