Identifying and Mitigating Potential Redlining Risks[1]

While the vast majority of FDIC-supervised institutions demonstrate success in managing fair lending risks in their operations, bankers often ask questions and seek more information on how to avoid or limit the potential risk of redlining. This document provides information on how banks can identify and mitigate redlining risk.

The term "redlining" is defined according to the Interagency Fair Lending Examination Procedures as when "[a]n 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. Redlining may also include 'reverse redlining,' the practice of targeting certain borrowers or areas with less advantageous products or services based on prohibited characteristics." [2] Redlining does not necessarily involve the complete avoidance of an area, but can exist if applicants are treated differently on a prohibited basis characteristic based on where they live. As a bank's lending patterns and the demographic characteristics of a given area may shift over time, so may the level of redlining risk. As a result, a bank may want to review its redlining risk profile on a regular basis.

To identify and mitigate potential redlining risk, banks may seek to:

- Understand the bank's market area, and the demographics of the geographies within that area;
- Evaluate the methods by which the bank obtains loan applications, including any marketing or outreach efforts and branches; and
- Assess the bank's lending performance within the market area.

The following provides information on each of these points.

Understanding the Bank's Market Area

A market area is generally where the institution markets for credit and where it plans to conduct business. Examiners evaluate a bank's redlining risk using what is referred to as the reasonably expected market area or "REMA." The Interagency Fair Lending Examination Procedures explain that a bank's reasonably expected market area is where the bank actually marketed or provided credit, or where it could reasonably be expected to have marketed and provided credit.[3] Examiners determine the REMA after considering (1) the institution's method of attracting business, such as the institution's marketing and outreach efforts and strategies, as well as the channels by which loan applications are taken, including but not limited to, branch or loan production office locations or mortgage subsidiaries, online applications, and an institution's use of third parties (such as mortgage brokers or realtors); and (2) where the institution has received loan applications and originated loans.

Separately, as required by the Community Reinvestment Act (CRA) rules, a "bank shall delineate one or more assessment areas within which the FDIC evaluates the bank's record of helping to meet the credit needs of its community."[4] In general, an assessment area includes the geographies where the institution has its main office, branches, and deposit-taking automated teller machines, as well as, the surrounding geographies in which the institution has originated or purchased a substantial portion of its loans.[5] While the bank's CRA assessment area often serves as the REMA, the Interagency Fair Lending Examination Procedures note that in some cases the assessment area may be too limited.[6] For instance, if a bank

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[1] The content provided in this document is for informational purposes to assist institutions in assessing potential redlining risk. There are no required actions for banks to take in response to the information provided.
[2] The Federal Financial Institutions Examination Council (FFIEC) Interagency Fair Lending Examination Procedures; page 29.
[3] The FFIEC Interagency Fair Lending Examination Procedures; page 32.
[4] 12 CFR § 345.41(a).
[5] 12 CFR § 345.41(c)(2).
[6] The FFIEC Interagency Fair Lending Examination Procedures; page 32.

has a number of loan production offices outside of its assessment area, the REMA may include a larger area. Determining what a REMA is will always depend on the specifics of the institution and its business strategy.

The following are examples of steps a bank can take to mitigate potential redlining risks relating to its market area:

- Familiarize loan officers and applicable loan staff with the fair lending requirements to ensure fair and equitable treatment in the lending practices throughout the entire area served by the bank.
- Periodically review where the bank is lending, especially if the bank has experienced recent growth or expansion activity. If the bank has expanded the geographic area it serves, this larger market may reflect a different demographic profile. Also, the demographic profile of the bank's market may shift over time, so a regular review can help spot any changes that may affect the bank's redlining risk.
- Pay close attention if the bank's assessment area includes only partial political subdivisions (portions of towns, cities, or counties). For example, if the bank delineated half of a county as its assessment area, it may want to review the demographics of the excluded areas to assess the risk of excluding minority populations from the bank's areas. The CRA rules require that an assessment area generally consist of one or more MSAs or metropolitan divisions or one or more contiguous political subdivisions, such as counties, cities, or towns.[7]

Evaluating the Bank's Marketing and Outreach

Banks can benefit by reviewing their marketing activities to understand if certain populations or geographies in the market area may potentially be excluded. For example, marketing that targets areas by zip code could result in minority areas being underserved relative to non-minority areas. Banks can review the content of advertisements to ensure they are designed to attract a range of applicants. In addition, banks can consider where promotional materials are distributed, the locations of any outreach efforts, and what geographies are served by any entities from which the bank solicits business (such as real estate agents or brokers).

In addition, strategies that focus marketing and outreach efforts on serving specific areas could result in other areas being served at a lower level. For instance, if a bank solely or largely markets its loan products in targeted geographies with a lower concentration of minority residents, it may result in the bank receiving fewer applications from residents living in areas with relatively high concentrations of minority group residents, resulting in a potential increase in redlining risk.

The following are examples of steps a bank can take to reduce potential redlining risk in its marketing and outreach efforts:

- Develop measurable standards for marketing, advertising, and outreach strategies and periodically assess the results to evaluate the success of these strategies in reaching different demographic populations in the market.
- Review marketing, including branching strategies (if used to reach applicants), to ensure they offer a reasonable level of marketing of credit products in areas with concentrations of minority group residents within the bank's market area. As part of any review, banks may want to review business contacts with third parties, such as real estate agents and homebuilders that may serve as a source of applicants for the bank's credit products.
- Analyze mortgage broker relationships to ensure they provide reasonable levels of outreach and marketing to areas with concentrations of minority residents compared to markets with lower concentrations of minority residents.

Assessing the Bank's Lending Performance

Assessing a bank's lending performance can help identify redlining risk. Data collected pursuant to the Home Mortgage Disclosure Act (HMDA), if applicable, provide the bank's percentage of applications and originations in majority–minority census tracts (that is, those having 50 percent or more minority population) and how it compares to data reported by other HMDA reporters operating in the same market. Such an analysis would show how the bank's lending activity compares to

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[7] 12 CFR § 345.41(c)(1).

peer lenders.[8] Banks can also analyze lending data to assess lending distributions in areas with concentrations specific populations, such as Black, Hispanic, Asian, Hawaiian, or Native American residents. In some cases, an area or neighborhood can be analyzed with less than 50 percent minority, racial, or ethnic populations when related risk factors or lending practices are identified. A bank may also analyze data by year to identify trends.

If HMDA data is not available, then the bank's percentage of applications and originations in majority-minority areas could be compared to demographic data, such as the percentage of owner-occupied housing units in the area for residential loans.

Banks can also benefit from conducting a visual analysis by plotting information on a map. This could include plotting both loan application and origination data. A visual analysis of loan penetration across areas that vary by minority demographics, along with an understanding of what factors are driving such lending patterns, can provide an effective redlining risk analysis. Banks can review these maps for gaps in lending penetration relative to branch and loan production office locations (if used to market credit), advertising efforts, loan applications received, and any other factors applicable to the bank. If the bank identifies gaps in lending in minority areas, it may also consider whether there are any barriers or other impediments to lending in these areas, and document the analysis. If a bank has a low volume of applications and origination data compared to other lenders in majority-minority areas, the bank may consider if there are lending policies, marketing strategies, procedures, and practices may be contributing to the low volume.

The following list provides examples of how a bank may assess potential redlining risk using its lending data:

- Develop procedures to evaluate data for consumer, commercial, or other significant lending categories by comparing originations in areas with relatively high concentrations of minority group residents to most recent available relevant demographics.
- If the bank is a HMDA-reporter, review whether there is a high rate of HMDA application denials or withdrawals in areas with relatively high concentrations of minority group residents, as compared to areas with relatively low concentrations of minority group residents. Determine whether there are any areas with little or no loan or application activity.
- If there is a low number of applications from majority-minority areas, consider whether any new strategies could help attract applications in a safe and sound manner from such areas.

Conclusion

As noted at the outset, FDIC-supervised institutions have generally demonstrated effective oversight over their lending activities to comply with fair lending laws. Understanding and monitoring the potential risk of redlining is one strategy banks can employ to maintain effective compliance with these laws. In evaluating potential redlining risk, banks may seek to better understand their market area and its corresponding demographics, determine how loan applications are generated, and then assess lending data to identify any differences between geographies with different demographics. Taking proactive steps can help mitigate potential redlining risks and help the institution comply with fair lending requirements. Supervised institutions with questions regarding this resource or other questions regarding consumer compliance are encouraged to contact their local FDIC field office or to review available online resources available on the FDIC's Banker Resource Center.

[8] Peer lenders are typically HMDA reporters (including commercial banks, savings institutions, mortgage companies, and credit unions) that received within the REMA, in each year analyzed, between half and twice the number of applications or originations as the institution being examined. During an examination, however, the FDIC will gather information from the institution and determine whether additions or deletions are appropriate.