New York Region Banker Teleconference
Fair Lending Risks From A Functional Area Perspective
July 17, 2013

The information contained in this presentation is for informational purposes only and is provided as a public service and in an effort to enhance understanding of the statutes and regulations administered by the FDIC. It expresses the views and opinions of FDIC staff and is not binding on the FDIC, its Board of Directors, or any board member, and any representation to the contrary is expressly disclaimed.

Agenda

- Business Planning Risks
  - Strategic planning & Product development
  - Policies and Procedures
  - Selection of 3rd parties to perform various functions
- Operational Area Risk
  - Marketing
  - Loan Originations
  - Servicing
  - Collections/Foreclosures
- Other High Interest Fair Lending Topics
  - Disparate Impact
  - Recent Violations

Business Planning Risk

- Several risks can be created due to an inadequate understanding of Fair Lending.
- Strategic or other business planning processes
  - How does the bank intend to grow (both products and footprint)
  - Potential risks generated:
    - Growing Market Area (Redlining Risk) – Is the bank expanding away from high minority areas? Has the bank defined its CRA Assessment Area in a way that abuts (but doesn't include) high minority areas?
    - Outsourcing (Multiple Risks Depending on the Activity) – Outsourcing to a 3rd party provider doesn't mean transfer of the Fair Lending risk and in some cases enhances it.
    - Product Development (Multiple Risks Possible) – New products are sometimes developed without adequate consideration for their impact on prohibited basis groups, if they create a risk for steering, or even reverse redlining (targeting a group for less favorable products).
    - Special Purpose Credit Programs – Must comply with the requirements of §1002.8 of Regulation B and the associated sections of the Official Staff Interpretations.

Operational Area Risk
Marketing

- There are several aspects of marketing that could present Fair Lending Risk:
  - Marketing Definition
    - Marketing is not limited to print, radio, and TV.
    - Includes any method used to attract applicants to loan programs.
  - Content
    - Advertisements with pictures should be reflective of the population in the bank's market area.
    - Include Compliance Officer or other person knowledgeable about Fair Lending risks when developing advertisements.
  - Circulation
    - Ads should reach all segments of and use languages broadly spoken in market area(s).

Operational Area Risk
Loan Originations

- This stage in the loan process is where judgment (discretion) has the greatest risk of impacting significant numbers of consumers.
- Risks to consider include:
  - Does the bank have any risk that a credit decision can be communicated before an application is completed?
  - Does the bank use any 3rd parties to help generate loan applications?
  - Is the bank only focused on residential lending when evaluating its Fair Lending risks?
  - How specific is the bank's pricing and underwriting standards for each type of loan offered?
  - Does the bank allow any discretion in pricing or underwriting (including exceptions)?

Loan Originations (Continued)

- Risks to consider include (continued):
  - Does the bank offer various types of residential loans?
  - How do you define a complaint? Do you have clear procedures to ensure complaints are addressed promptly and analyzed for the root cause?
  - Does the bank know its market demographics and how its lending compares to others?
  - Can the bank’s commercial loan officers underwrite and approve accommodation loans?

Operational Area Risk
Servicing

- There are several aspects of servicing that could present Fair Lending Risk.
- Risks to consider include:
  - Has the bank adjusted existing credit?
  - Has the bank outsourced any portion of loan servicing?
  - Are staff allowed to waive any type of account fees?
  - Are the bank's practices for customer contact standardized?

Servicing (Continued)

Risks to consider include (continued):

- Are the bank's procedures for communicating with delinquent customers clear and is this process being monitored?
- Who makes the decision to send a customer to the collections or foreclosure staff?
- Is there any pattern in the bank's data that would suggest certain prohibited basis groups receive a negative outcome more frequently?

Operational Area Risk Collections/Foreclosures

- Although this aspect of credit operations was not a major risk area during the "boom" years it is now.
- There are several aspects of servicing that could present Fair Lending Risk.
  - Policies/procedures should be reviewed and updated, and like origination policies, should provide clear standards and document/monitor exceptions.
  - It is very difficult to monitor for consistent treatment of similar customers when the procedures do not provide clear standards that influence the ultimate action.
  - Monitor for trends in the data that would indicate a prohibited basis group could have been treated less favorably.
  - Document decisions and supporting facts.

Other High Interest Fair Lending Topics
Disparate Impact

- Disparate Impact definition.
- This "theory of proof" has been around for a long time but used more frequently in the last several years as more sophisticated regression models were developed to help support the conclusions.
- Numerous cases have been pursued by all regulatory agencies under this theory of discrimination.
- Consumer Financial Protection Bureau (CFPB) issued a Bulletin (2012-04) that discusses their intention to use disparate impact when evaluating practices that impact consumers.

Spousal Signature Violations

- Spousal Signature Violations
  - Many violations appear to result from a real estate attorney's focus on perceived risk to collateral access without adequate legal analysis to support the actual need.
  - Failure to follow Regulation B, Official Staff Interpretations, and the two FDIC-issued Financial Institution Letters (FILs).
  - New York Region reviews have not identified case law in the New England or mid-Atlantic states that supports the need for credit instruments from a non-applicant spouse in addition to security instruments.

Discriminatory Pricing Violations

- Discriminatory Pricing Pattern
  - We are seeing some cases where there is discretion in pricing for certain products, and there is also a disparity in how the pricing affected an identified prohibited basis group.
  - The discretion can be broad.
  - Don’t forget to consider fees; this includes the ability to waive, apply, or modify anything that impact final pricing or subsequent loan costs.

Conclusions

- Monitor the Fair Lending guidance provided in the FDIC compliance manual, Department of Justice (DOJ) settlements, and financial institution guidance on FDIC.gov.
- If there is “discretion” there is Fair Lending Risk that needs management controls and monitoring.
- Third parties present monitoring challenges – your bank is still responsible for 3rd parties when they perform bank functions.

References

- DOJ Cases: http://www.justice.gov/crt/about/hce/caselist.php
- CFPB Bulletin 2012-04 (Fair Lending): http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf
- FDIC Regulatory Calendar: http://www.fdic.gov/regulations/resources/cbi/calendar.html
- FDIC Fair Lending Examination Reference Materials: http://www.fdic.gov/regulations/examinations/
- Spousal Signature FILs:
  - FIL-6-2004 (January 13, 2004): *Guidance On Regulation B Spousal Signature Requirements* http://www.fdic.gov/news/news/financial/2004/FIL0604.html
  - FIL-9-2002 (February 4, 2002): *Guidance on Avoiding Violations of the Spousal Signature Provisions of Regulation B* http://www.fdic.gov/news/news/financial/2002/fil0209.html

Contact Information

Joe Chaloux – Fair Lending Examination Specialist

jchaloux@fdic.gov

Rose Egbuiwe – Fair Lending Examination Specialist

regbuiwe@fdic.gov