

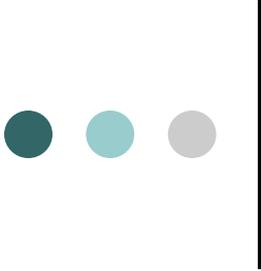


FDIC

Atlanta Region's Regulatory Conference Call Series

*Managing Your Bank's Fair Lending
Program Risks*

June 16, 2011



Managing Your Bank's Fair Lending Program Risks

Presented by:

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Atlanta Region's Fair Lending Examination Specialists

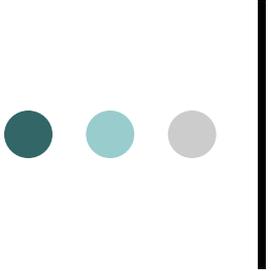
➤ **Phyllis M. Patton**

Assistant Regional Director (Compliance)

Presentation Overview

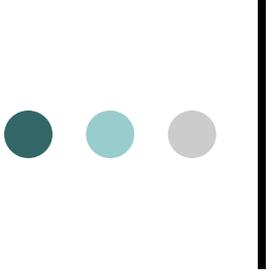
- ◆ Introduction
- ◆ Fair Lending Risk Indicators
- ◆ Mitigating Fair Lending Risks
- ◆ Managing Fair Lending Risks
- ◆ Effects of Discrimination on a bank's compliance and CRA ratings





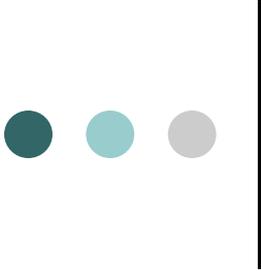
Potential Fair Lending Risk Factors

1. Compliance Program
2. Underwriting
3. Pricing
4. Marketing / Advertising
5. Steering
6. Redlining



Additional Fair Lending Risk Considerations

7. Age-Based Deposit Accounts with Credit Features
8. Spousal Signature / Guarantee
9. Consumer Lending
10. Commercial Lending

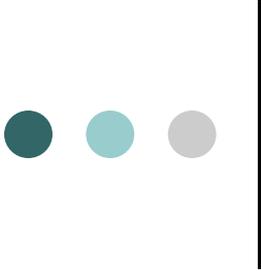


Performing Risk Assessments

Risk Assessment Definition: An effort to identify and measure the risk inherent in the bank's lending processes and to determine what control and monitoring mechanisms are in place to protect against illegal discrimination.

Benefits of a Risk Assessment:

- **Helps develop a strong understanding of the bank's credit processes;**
- **Identifies weaknesses in the program; and**
- **Provides clues as to how to minimize and/or avoid risk.**



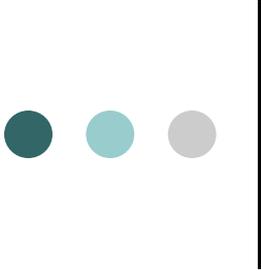
Performing Risk Assessments (Continued)

When conducting a risk assessment, at a minimum you should review:

- **Written policies and procedures**
- **Board and management reports**
- **Training records**

Reference Material: FIL-148-2008 (December 30, 2008), “*FDIC Teleconference on Conducting a Fair Lending Risk Assessment*”

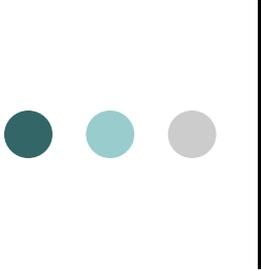
<http://www.fdic.gov/news/news/financial/2008/fil08148.html>



Mitigating Fair Lending Risk Areas

Compliance Program Risks

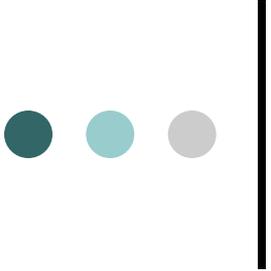
- Failure to monitor**
- Failure to ensure accuracy of lending data**
- Failure to provide adequate training**



Mitigating Fair Lending Risk Areas (Continued)

Three methods of proof of lending discrimination:

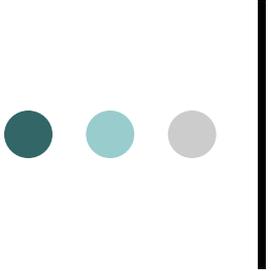
- **Overt Evidence of Disparate Treatment**
- **Comparative Evidence of Disparate Treatment**
 - Redlining
- **Evidence of Disparate Impact**



Mitigating Fair Lending Risk Areas (Continued)

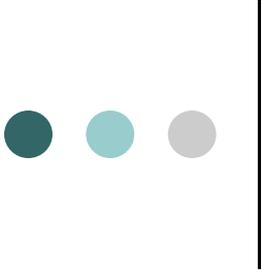
Ways to mitigate compliance program risk:

- ❑ Ensure policies and procedures are accurate and updated; and**
- ❑ Ensure Senior Management and Board of Directors are committed to establishing and maintaining a strong fair lending program**



Potential Fair Lending Risk Indicators - Underwriting

- Substantial disparities among the approval and denial rates;
- Vague or unduly subjective underwriting criteria;
- Lack of clear guidance on making exceptions to underwriting criteria including credit scoring overrides;
- Lack of clear loan file documentation; and
- Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs.



Mitigating Fair Lending Risk Areas (Continued)

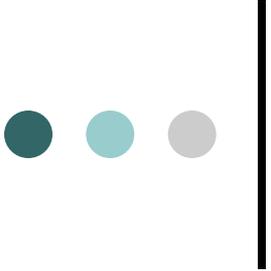
Underwriting

- Written Policies

- Discretion = Risk

- Documentation

- Monitoring



Mitigating Fair Lending Risk (Continued)

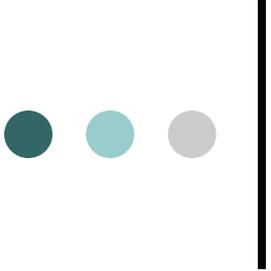
Credit Scoring System

What is a Credit Scoring System?

What is an Override?

Low Side

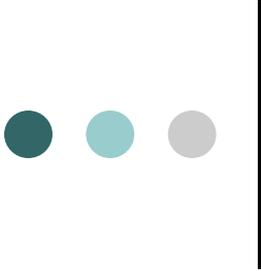
High Side



Credit Scoring System

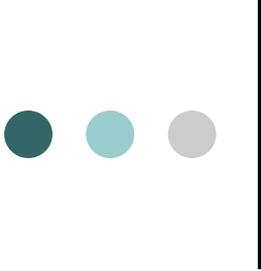
Disparate treatment can occur at three stages in the use of a custom credit scoring system:

- *Data development and data input*
- *Credit scoring system factors and requirements*
- *Discretionary overrides*



Potential Fair Lending Risk Indicators - Pricing

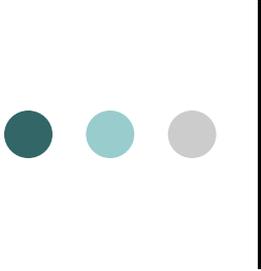
- Presence of broad discretion in loan pricing;
- Use of risk-based pricing that is not based on objective criteria or applied consistently;
- Substantial disparities among prices being quoted or charged to applicants of a prohibited basis;
- Consumer complaints alleging discrimination in loan pricing; and
- In mortgage pricing, disparities in the incidence or rate spreads of higher-priced lending by a prohibited basis as reported in the HMDA data.



Mitigating Fair Lending Risk Areas (Continued)

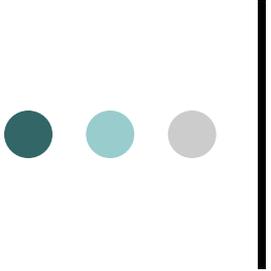
Pricing

- Uniform Guidance
- Discretion = Risk
 - Documentation
 - Monitoring
 - Training
 - Periodic File Review



Potential Fair Lending Risk Indicators - Advertising

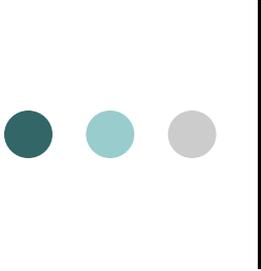
- Advertising patterns or practices that a reasonable person would believe indicate prohibited basis customers are less desirable;
- Advertising only in media serving non-minority areas;
- Use of marketing programs or procedures for loan products that exclude one or more regions that have significantly higher percentages of minority group residents; and
- Consumer complaints alleging discrimination in the advertising or marketing of loans.



Mitigating Fair Lending Risk Areas (Continued)

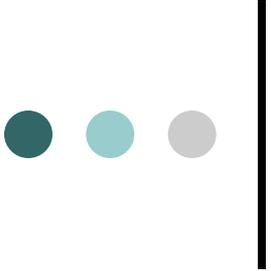
Marketing / Advertising

- Review advertisements for fair lending compliance;
- Ensure advertisements cover entire assessment area;
- Remain cognizant of various forms of media used to advertise; and
- Periodically assess marketing program for fair lending.



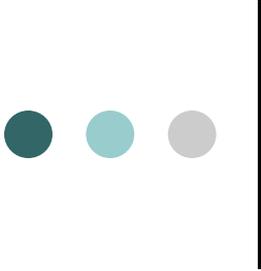
Potential Fair Lending Risk Indicators - Steering

- Lack of clear, objective and consistently implemented standards for
 - (1) referring applicants to subsidiaries, affiliates, or lending channels within the institution;
 - (2) classifying applicants as “prime” or “sub-prime” borrowers; or
 - (3) deciding what kinds of alternative loan products should be offered or recommended to applicants.
- 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;



Potential Fair Lending Risk Indicators - Steering

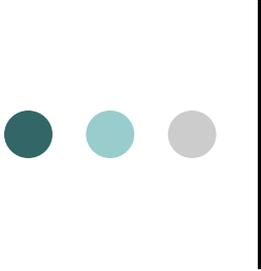
- Significant differences in the percentage of prohibited basis applicants in loan products with specific features relative to control group applicants;
- Institutions that have one or more lending channels that originate the same loan product, any significant differences in the percentage of prohibited basis applicants in one of the lending channels compared to the percentage of prohibited basis applicants of the other lending channel; and
- Consumer complaints alleging discrimination in residential loan pricing or product placement.



Mitigating Fair Lending Risk Areas (Continued)

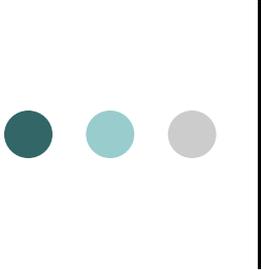
Steering

- Establish clear & objective standards for referring applicants to subsidiary, affiliates or other lending channels:**
 - Classifying applicants as prime or sub-prime borrowers; and**
 - Deciding alternative loan products**
- Monitor lending**
- Review compensation agreements**
- Reminder: Final decision of choice of loan product is the applicants. Harm is not required to prove steering.**



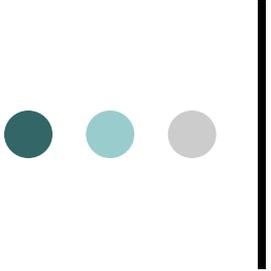
Potential Fair Lending Risk Indicators - Redlining

- Significant differences in the number of applications received, withdrawn, approved not accepted, and closed for incompleteness or loans originated in those areas in the institution's market that have relatively high concentrations of minority group residents;
- Significant differences between approval and denial rates for all applicants in areas with relatively high concentrations of minority group residents;
- Significant differences in the number of originations of higher-priced loans or loans with potentially negative consequences for borrowers in areas with relatively high concentrations of minority residents;



Potential Fair Lending Risk Indicators – Redlining

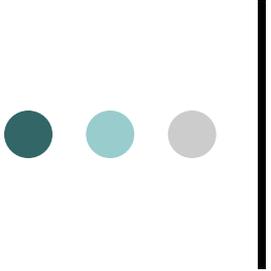
- Explicit demarcation of credit product markets that excludes MSAs, political subdivisions, census tracts, or other geographic areas within the institution's lending market or CRA assessment areas and having relatively high concentrations of minority residents;
- Difference in services available or hours of operation at branch offices located in areas with concentrations of minority residents; and
- CRA assessment area appears to have been drawn to exclude areas with relatively high concentrations of minority residents.



Mitigating Fair Lending Risk Areas (Continued)

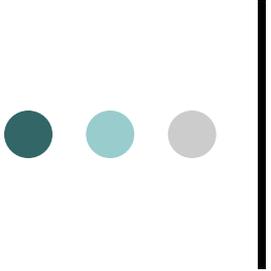
Redlining

- Review policy for overt statements;
- Monitor branch distribution and services offered;
- Review lending patterns in minority and non-minority tracts (HMDA Banks); and
- Geo-code loans periodically (Non-HMDA Banks).



Mitigating Fair Lending Risk Areas (Continued)

- Age-Based Deposit Accounts**
 - Credit Features tied to deposit account**
 - Age must be 62 and older**
 - Review products for Fair Lending**



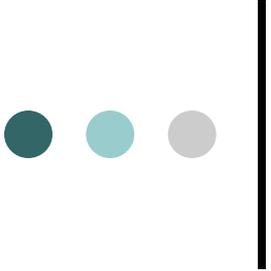
Mitigating Fair Lending Risk Areas (Continued)

Spousal Signature / guarantee

- Establish procedures regarding spousal signature;**
- Document file to evidence how and why signature was obtained; and**
- Sample files to test policy.**

Joint Applicants

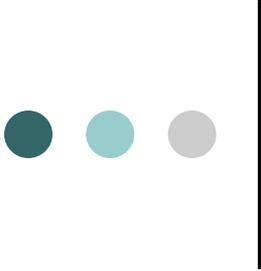
- Documentation: Notice of Intent for Joint Application**



Mitigating Fair Lending Risk Areas (Continued)

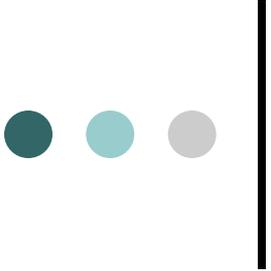
- Consumer Lending

- Commercial Lending



Managing Fair Lending Risks

- ❑ **Establish limits on loan pricing discretion;**
- ❑ **Establish documentation requirements;**
- ❑ **Implement second level reviews;**
- ❑ **Perform fair lending self-evaluations;**
- ❑ **Train staff members; and**
- ❑ **Monitor fair lending program.**



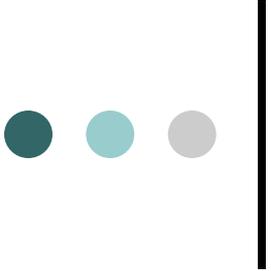
Fair Lending Discrimination Effects on Ratings (Compliance & CRA)

- Downgrade in compliance & CRA ratings
- Prohibit Mergers and Acquisitions
- Possible adverse impact on bank's reputation
- Assessment of civil money penalties
- Restitution to affected borrowers
- Possible referral to DOJ, HUD, and/or FTC

Managing Your Bank's Fair Lending Program Risks

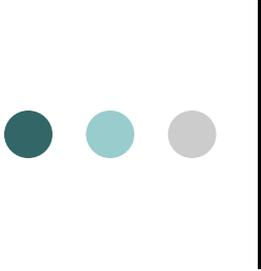
Questions?





RESOURCES

- ❑ Link to Conducting Fair Lending Risk Assessment PowerPoint Presentation dated January 14, 2009:
<http://www.fdic.gov/news/news/financial/2008/fil08148.html>
- ❑ Link to FFIEC Interagency Fair Lending Exam Procedures: <http://www.ffiec.gov/PDF/fairlend.pdf>
- ❑ Link to FFIEC HMDA Data:
<http://www.ffiec.gov/hmda/default.htm>



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