Good afternoon. I am John Vogel - Regional Director for the FDIC's NY Region and I would like to welcome everyone and thank you for joining us for our quarterly industry calls. Today, our Regulatory Conference Call is entitled "Fair Lending Risks from a Functional Area Perspective". During today's call we will discuss fair lending risks inherent in many functional areas of the bank including: business planning, marketing, outsourcing of bank functions, as well as loan origination and servicing.

The FDIC and our supervised banks have a shared desire and a mutual interest in ensuring consumers are treated equally and fairly during the lending process. As a regulatory agency, we are committed to protecting consumers and ensuring adherence to the letter and spirit of the fair lending laws, including the Equal Credit Opportunity Act and the Fair Housing Act. As a bank, you are committed to ensuring a positive banking experience with consumers, including their equal and fair treatment during the lending process. We hope this call provides participants with a broad perspective of potential fair lending risk areas and enhances your understanding of Fair Lending. We very much appreciate your participation in today's call.

Your confirmation email included a link to the Power Point slides for the various topics being covered. The PowerPoint slides should aid you in following today's presentation and can be used for future reference. If you have any questions relating to this presentation, you can contact the presenters or email us at NyCalls@fdic.gov. There will be a question and answer session at the end of the presentation – the operator will provide procedures for calling in a question. Please note that you may also send email questions at any time during the presentation to NYCalls@fdic.gov. If you have any questions after the presentation, please email those questions to the contacts listed on Slide 15 of the Power Point slides. A written transcript and Q&A document will be posted to the same weblink you used to register for today's call.

With me today are two presenters with considerable knowledge pertaining to our subject matter: Regional Fair Lending Examination Specialists Rose Egbuiwe and Joe Chaloux. It is now my pleasure to turn the program over to Joe, who will begin the presentation.

Before I begin, I would call your attention to the first slide in our presentation and emphasize that the information we are going to present is based on our experience and should not be viewed as FDIC Policy.

While this information should provide important insights into the examination process, it should not be viewed as all inclusive and unchanging. In reality, Fair Lending risks are dynamic, meaning they change with the products offered by the bank and the changing demographics of your lending area, and will require ongoing monitoring by your institution.

There has been a lot of “chatter” in industry publications that the regulators have changed the way they evaluate compliance with the Equal Credit Opportunity Act (also known as ECOA) and the Fair Housing Act. We want to mention that the Federal Financial Institution Examination Counsel’s (also known as the FFIEC) Interagency Fair Lending Examination Procedures - have remained the same since 2009. We continue to use a risk-scoped examination process, and this might result in changes in the loan products or lending activity we review from exam to exam. Also, advances in technology have enhanced the FDIC’s ability to identify and evaluate fair lending risk.

While risk-scoping and technology advances may impact the scope of our Fair Lending review at your bank, and may result in different loan product or lending activity reviews, we want to highlight some facts that underscore FDIC-supervised institutions’ overall Fair Lending profile. In 2012 we conducted 179 exams, 1 of which resulted in a referral to the Department of Justice – also referred to as the DOJ - and as of June 30, 2013, we have conducted 58 exams, 1 of which resulted in a referral to DOJ.

So while the perception out there may be that our Fair Lending focus has increased over time or we have been identifying more Fair Lending issues, by and large, the majority of our FDIC-supervised institutions are not the subject of Fair Lending-related enforcement action.

Our intention with this call is to help you recognize Fair Lending risks that you may not have thought of previously. Proactively identifying and implementing controls to mitigate any type of Fair Lending risk posed by your bank's operations is something we expect banks to do. It is beneficial to do this for many reasons. For example, it will enable your bank to provide the exam team with a clear picture of your bank's fair lending risks and what controls are in place to mitigate the risk. This should assist in the efficiency of the fair lending review and highlight the bank's ability to identify risk and control for it.

In some examinations, we do see situations where the bank did not properly identify and control their Fair Lending risk, resulting in violations. The following are potential consequences of a Fair Lending violation:

- Impact on compliance and/or CRA ratings.
- Restitution to impacted customers (along with a written notice to the consumer that explains the activity was a violation of ECOA and that they may wish to consult an attorney for additional rights).
- Referrals to the DOJ – which is required by statute for pattern or practice violations of ECOA.
- Formal and/or informal enforcement actions (including Civil Money Penalties, also known as CMPs).
- Reputational risk - formal enforcement actions and DOJ settlements are generally available to the public and in the case of DOJ, actions often get reported by the media.

Let's now turn the discussion towards starting the presentation. Before we turn to Slide 2 and go over the agenda, it may be helpful to ensure everyone understands what certain Fair Lending-related terms will mean when used in this presentation.

- Redlining – This is one of the terms that seem to elicit surprise when it is discussed during examinations. Some bankers may think you need to have a map on the Boardroom wall with a red line drawn around certain towns or neighborhoods to have a redlining risk. Redlining risk is much broader than that and redlining risk indicators noted during exams is much more subtle.

Examiners assess a bank's efforts to reach all segments of its trade area, including loans (through marketing efforts), services (through hours or products that might vary by branch), or patterns of growth that move away from high minority areas. High minority areas are defined as census tracts where 50% or more of the population identified as minority by the US Census Bureau. If you have not reviewed the 2010 Census I would encourage you to do so.

Examiners will consider these potential risk indicators as part of the FL exam scoping process. Of course if they see a map with certain neighborhoods or towns excluded or see committee minutes/loan files that contain statements that certain neighborhoods are less desirable, they will also consider that information.

- Reverse-Redlining – This means targeting certain areas with less favorable products. I'm not aware of any specific violations related to this practice but I could envision the following scenario leading to a reverse-redlining risk:
    - A hypothetical bank has both an in-house mortgage department as well as a mortgage subsidiary. They offered similar loans products, but serve different markets. The bank loan originators focus their activities in high minority tracts, while the mortgage subsidiary focuses on non-minority areas. If the bank products were priced higher or had some other less favorable feature, like a prepayment penalty, a risk for reverse-redlining would exist.

- Steering – This is a lack of choice when the applicant(s) qualify for more than one product – it doesn't need to be a "bad" loan product. We will discuss it a bit more later on in the presentation. Steering could happen with products within the bank, referrals to 3rd parties, or some combination of both options. We have seen instances in which the DOJ pursued cases where the minority borrowers appeared to have been steered to high-priced loan products when they could have qualified for conventional loans.

Presented on slide 2 is the Agenda

Our intention is to focus on various business activities, and within these functional areas, highlight how violations or risks may go unrecognized by bank management.

- The first topic we will discuss is Business Planning Risks. Here I will discuss the highest level planning done by bank management. Mistakes made at this stage often go unidentified by staff involved in subsequent stages of implementation and application.
  - Within the topic of Business Planning Risks, we will discuss four general areas:
    1) Strategic Planning
    2) Product Development
    3) Developing and Implementing Policies and Procedures, and
    4) Use of 3rd Parties.

- Rose will then discuss Operational Area Risk and how Marketing, Loan Originations, Servicing, and Collections/Foreclosures each have numerous Fair Lending risk factors.

- Last, I will discuss Other High Interest Fair Lending Topics including Disparate Impact to help you understand what it is and what it is not, as well as highlight some specific issues that continue to lead to violations.

Moving to Slide 3 – Business Planning Risk

Business planning sets the foundation for all management activities that follow. From a Fair Lending perspective, it is vital to have someone familiar with Fair Lending concepts and risk indicators actively involved in the business planning and development phase.

One of the reasons that the FDIC expects the Board to receive Fair Lending training is because the Board sets the course of the bank, particularly in areas like branch or product growth targets, and determining the types of credit products the bank will offer.

In fact, the DOJ has pursued Redlining cases where the bank's historic growth patterns or comments regarding where the bank wanted to expand suggested a desire to avoid high minority areas.

- Are you growing away from high minority areas?
  - If you are opening new branches or closing existing ones, does your bank look at all areas and evaluate them objectively regarding profitability or other business goal you wish to achieve?
  - Does your bank have unusually shaped or geographically separated assessment areas which appear to avoid high minority tracts?
  - Do you have census tracts with high percentages of minority population just outside your CRA assessment area or defined lending/market area?

- While none of these planning activities in themselves are proof of redlining, they are risk indicators that will receive higher scrutiny from exam staff.

If during the planning process bank management considers outsourcing lending-related functions, you need to consider several risks.

- The following points highlight some risks associated with 3rd party relationships.
  - You may <u>not</u> think that deposit products represent Fair Lending risks, but some banks have implemented vendor marketed age-based club accounts. If the club account has an associated credit feature that has an age limit of less than 62, this may result in an ECOA violation. An example of this is when the bank creates a

deposit account with a minimum eligibility age of 50, and along with other features of the deposit account the bank gives a 25 basis point reduction for its home equity loans, and this same loan rate reduction is not provided to people less than age 50 who have other deposit products.

- Another unrecognized risk related to 3rd party contracts relates to how credit reports are pulled and priced for joint applicants. The type of credit report pulled is often conditioned on the marital status of the joint applicant with pricing also being different. Numerous violations have been noted due to a credit report pricing difference conditioned on marital status.
- Agreements with dealers or brokers present 3rd party risk because the bank may be held responsible for practices allowed or supported through those agreements. Some practices that have caused regulatory concern include discretion in pricing or credit product selection practices.
- Remember that when you transfer activities to a 3rd party, its policies and procedures effectively become your policies and procedures. You need to know what the 3rd party is doing and how it will monitor the risk inherent in its operations. Also, remember that it can be an affiliated or unaffiliated 3rd party.
- Finally, when you partner with other lenders and refer applicants to them for certain credit products, you could have an elevated risk for Steering.

- Of course the same risks exist when banks develop their own products.

Regarding Product Development - When you put together a product development team, you should include the Compliance Officer or someone well versed in fair lending concepts and the various prohibited basis groups that the product might impact.

- There have been violations of discrimination noted where products were developed that set different standards based on marital status, age, gender, public assistance income, and familial status. A couple of examples are:

- Marital Status – Instances where a bank evaluated the credit score or income differently based on the marital status of the joint applicants.
- Age – Club accounts with a credit feature – as we discussed in an earlier example. Another age example is offering a <u>less restrictive</u> credit evaluation for applicants under 21.
- Gender or Familial Status – Denial of application based on one of the applicants being on maternity leave.
- Public Assistance Income – Grossing up some, but not all types of public assistance income.

- Another important aspect of Product Development is well written policies and procedures that are monitored for compliance.
  - Vague standards within the loan policies will generally cause an examiner to further explore those standards during a Fair Lending review. Vague guidance generally elevates the risk for inconsistency in how those terms are interpreted by the people applying the terms or guidance. In my experience, it is not uncommon to see terms like "strong credit" or "established relationship" within loan policies, which are examples of vague standards.
  - If your bank wishes to retain vague standards in pricing or underwriting guidance you should:
    - Expect to articulate what those terms mean and explain how the bank communicates that definition to lending staff.
    - Know that vague terms make it very difficult to establish an effective exception policy, or to monitor for consistent treatment of customers.
    - Realize that if lending data show a disparity that negatively impacts a prohibited basis group, the vague standards are much

harder to compare and defend. Discretion in loan pricing will be covered in more depth later in the presentation.

- Clear standards are more likely to be consistently applied by underwriters or loan origination staff. Also, exceptions are recognized as appropriate business decisions and are not discouraged by examiners. However, we would expect that the use of exceptions - which is a form of discretion - be monitored to ensure similar applicants are considered for similar exceptions.

With respect to Special Purpose Credit Programs - If the bank believes there are segments of its community that need special consideration to qualify for certain products, the bank <u>must</u> develop a Special Purpose Credit Program as defined in Section 1002.8 of Regulation B and the associated Official Staff Interpretations.

- There are very specific standards in Regulation B that need to be met when the bank develops a Special Purpose Credit Program.

<u>Now we will move to Slide 4</u> where Rose will discuss various risks in several operational areas.

Thank you Joe.

Marketing is a functional area which might be overlooked when the bank considers Fair Lending risk mitigation. Advertisements are often reviewed by the Compliance Officer for compliance with regulations such as Truth in Savings, Truth in Lending, and Advertisement of Membership, but might not reviewed for redlining, steering, or discouragement risks.

- Marketing committees should include the Compliance Officer in the developmental stages. The Compliance Officer might notice fair lending risks that need to be addressed early in the process and therefore make the process more efficient.
- Marketing is larger than what the bank places in print or other recognized media; it is anything the bank does to attract and retain customers.

- The marketing plan is an indicator of "who" the bank wishes to serve and where the bank is attempting to grow.
- Regarding content, does your bank use targeted advertising? If so, who is targeted and perhaps more importantly, from a Fair Lending perspective, who is not?
- When the bank uses traditional advertising media, do the ads reflect the demographics and languages of the people who make up a significant portion of the market/trade area? While there is no regulatory requirement to advertise in different languages, if examiners see low application rates for certain segments of the bank's community, we will look to how the bank attracts customers and then look to see if that same type of outreach is equally applied to the under-represented segments.
- We are not suggesting the bank spend money on advertisements that do not produce results, but we do expect the bank to at least attempt to reach all segments of its market/trade area and evaluate the effectiveness of the campaigns using objective and consistent standards.

<u>We will now move to Slide 5</u> – Loan Originations

We could easily spend all the time allocated for this call on this one area, but we will try to focus on activities that most frequently result in violations because they had not been recognized as a risk area by bank management.

- There have been instances where loan originators or other bank staff gather information at the pre-application or inquiry stage and then communicate a credit decision based on that data, even though they have no underwriting authority.
    - The most common items evaluated by non-underwriting staff are estimates of value for the collateral or payment history from credit reports.
    - If a customer is told they would not qualify, it turns what was an inquiry into an application under ECOA and a denial notice needs to be provided.

  - The risk of discouragement is real, even though it is difficult to find a paper trail or know the characteristics of the persons not proceeding to a written application. It would be very hard for a bank to defend itself against a consumer complaint asserting discrimination if this practice was identified during an investigation of that complaint.
  - This activity happens most often in commercial lending, but has been noted in residential channels as well.
  - One of the management controls that can identify this practice is to cross reference the reports your bank receives from credit report providers with application activity.

- If your bank has any contractual relationships with 3rd parties to generate loan demand, you could be held responsible for their activities. This includes loan brokers, indirect lenders, real estate brokers, or marketing firms.
  - If your bank's agreement with these parties allows discretion by the 3rd party, such as in indirect auto lending, the bank can be held responsible for how that discretion is used.
- It is important that we stress that ECOA and the FFIEC Fair Lending Examination Procedures apply to all types of credit products and all aspects of credit operations. Although many of your past examinations may have focused on residential lending, examiner's reviews are not limited to Home Mortgage Disclosure Act (also known as HMDA) reported loans.
  - You should anticipate that examiners will be asking for, and evaluating loan portfolio downloads, such as an ALERT file.
  - We will be reviewing for any inconsistency in the pricing of the various loan products.

  - If your bank allows any discretion in pricing for any loan product, including exceptions, these judgmental decisions are Fair Lending risks that management needs to be aware of and monitor.
  - While it is recognized that evaluation of commercial loans is difficult, bank management needs to recognize that ECOA applies to commercial lending. Even though we have not historically cited violations in the product type, beyond spousal signature violations, Fair Lending risks exist. Risk based pricing - without clear adjustments for various risk factors, creative underwriting, and no formal application processes often exist in the commercial lending departments and present significant challenges for effective monitoring by banks.

- If an examiner identifies discretion in pricing or underwriting for any loan product, we will evaluate if the discretion was exercised in a manner that disadvantaged an identifiable prohibited basis.
  - Examiners will look at the data available to determine which prohibited basis can be identified for comparison to the group as a whole. Based on my experience these generally include age, gender (based on given name), ethnicity (based on surname), or race (based on surname or geographic location).
  - As noted earlier, the most effective management control is clear policies and defined standards, along with sufficient documentation when exceptions are made.
  - Automated underwriting <u>does</u> provide improved management controls, but many systems only provide a "recommendation" and almost always require some level of activity by the underwriter. What the underwriter does in following up on the conditions or questions is another area where discretion can occur.

<u>Moving on to Slide 6</u> which discusses additional Loan Origination risks

Another risk to consider is Steering. If your bank offers various types of residential loans there is some level of Steering Risk.

- Remember, Steering is defined as a lack of choice on the part of the applicant. It is also important to remember that the product doesn't need to be a "bad" product, or to cause harm for steering to have occurred. The best management control in this area is to present the various products the customer is likely to qualify for and document that the customer selected the product they felt best fit their needs. This is particularly important when you have the ability to place applicants in products that are similar but priced differently, or have credit terms like pre-payment penalties.

We would also recommend monitoring the composition of various products. If you see a disproportionate number of an identifiable prohibited basis in any given product you should be able to provide a reason why this occurred. Being a "less sophisticated borrower" is not a good business reason.

Regarding Complaint management – how do you define complaints and manage the complaint resolution process, including the root cause of recurring complaints? You should know what your customers are saying about your bank and don't be dismissive of those statements. We view consumer complaints, particularly those that assert discrimination, very seriously and evaluate Fair Lending complaints at every exam.

Also, know your data and the demographics of your market. You can expect examiners will be asking questions if the demographic composition of your loan data is not consistent with the demographics of your market/trade area. Not that it would be a violation if there is a difference, but you can expect the examiners to explore the reasons behind the difference.

Be aware of what commercial lending is doing, including what are often called "accommodation loans" for residential or other consumer products.

- We have heard statements from some banks that commercial lending departments can originate non-commercial loans for their business customers.
- The bank needs to be aware that when it allows this practice, they assume the risk that commercial loan officers may not underwrite the loans following the appropriate policy standards. The result could be your commercial department is setting a standard against which all consumer denials could be measured.

<u>We will now go to Slide 7</u> - Servicing

Although servicing is one of the longest duration activities in a lending relationship, it often receives little attention from a Fair Lending risk management perspective.

- First, if any of your products allow for changes, such as risk based pricing adjustments or changes in account terms, such as freezing or reducing line-of-credit limits, do you have clear objective standards that can be consistently applied? Are exceptions allowed and are they monitored for possible patterns that negatively impact certain groups?

- If you use an outside firm to identify "declining markets," did you evaluate their methodology to ensure it is objective and doesn't consider the racial composition of that market?

- As we have mentioned previously, if your bank chooses to transfer the servicing function to a 3rd party provider, it doesn't transfer responsibility for what that provider does.

- Does your agreement with the 3rd party cover likely risks, such as complaint response, fee waivers, and communication when a customer is late making payments? Does the agreement include provisions that allow for you to monitor what that entity is doing to manage those risks?

- Did you review the policies and procedures the 3rd party will use to ensure they are comprehensive and consistent with what the bank would expect if it performed the function itself?
- Does the contract include a requirement that the 3rd party send periodic reports and changes made to its policies and procedures?

- One of the risks for inconsistent treatment of customers during servicing is consideration of the waiving of late fees.
- Does your bank have clear standards?
- Are the characteristics of customers who received a fee waiver analyzed for any pattern that would suggest any identifiable prohibited basis group appears to be treated less favorably?

- The ways in which a customer might communicate with the bank regarding an open account are numerous. If the bank doesn't have a detailed process to ensure those comments or questions reach the right person, it could enhance the risk of inconsistent treatment.

<u>We will now move to Slide 8</u> which discusses additional Servicing risks

Assuming you have developed standardized policies and procedures to handle customers' questions regarding their accounts, how do you monitor to ensure they are being followed?

- We expect the same level of management controls to be applied in servicing of loans that would occur during the credit decision stage.
- We have received consumer complaints asserting that they were mistreated when attempting to resolve servicing questions or disputes.
- The national news regarding servicing settlements has raised public awareness about consumer rights and bank responsibilities when it comes to loan servicing.

When a customer begins to have difficulty making payments does the bank have specific processes to follow to assist all "similarly situated" customers in reaching a work-out or accommodation? Has your bank analyzed the characteristics of the customers who received favorable outcomes compared to those that did not?

- Has your bank looked to see if there is any pattern in the data regarding how long it took to reach the various outcomes for the different groups?

We will now move to Slide 9 and discuss Collection and Foreclosure risks.

Once a customer has reached this stage of the credit process, how they are treated during the actual recovery of the collateral will present continued fair lending risks?

For several years, foreclosure and collection activities were very limited and many banks have not reevaluated the procedures for these types of activities. As with all other aspects of the credit transaction, clear policies that are effectively monitored are key management controls.

- As noted previously in this presentation, if your bank has engaged 3rd parties to handle collections or foreclosures, the bank is likely still responsible for what they do. How closely do you monitor the practices of your foreclosure attorneys or collection staff?

- Once a foreclosure has occurred, what are the bank's procedures for maintaining the property? Some community groups have filed complaints with the Department of Housing and Urban Development (also known as HUD) that properties in high minority areas are not maintained at a level that is consistent with non-minority areas. On June 6th of this year the National Fair Housing Alliance announced a settlement on one of these complaints.

- If the bank will hold rental real estate in Real Estate Owned (also known as REO), has it considered the additional responsibilities under the Fair Housing Act that apply to rentals? The transfer of the property to an affiliate or management company will rarely protect the bank against claims of discrimination.

I will now return the discussion to Joe who will discuss Other High Interest Fair Lending Topics.

Thank you Rose.

<u>On Slide 10</u> you will see what is perceived as one of the "Hottest" of Hot Topics in Fair Lending – Disparate Impact.

First let's start with a little background information. There are 2 theories of proof in discrimination:

The first theory is Disparate Treatment.

- Disparate Treatment includes two subcategories: Overt Evidence and Comparative Evidence.
  - Overt Evidence – Is verbal statements or written policies that articulate a discriminatory bias or set a discriminatory standard. An example would be where the bank policy articulates different standards based on a person's marital status.

  - Comparative Evidence – This is a practice or policy which has a discriminatory outcome that cannot be explained by legitimate non-discriminatory factors. An example would be a comparative file review where equally qualified customers did not receive similar outcomes in either pricing or underwriting. This theory doesn't require proof of the bank's motives, only that similar customers from both the prohibited basis group and non-prohibited basis group were treated differently.

The second theory is Disparate Impact.

- Disparate Impact is when a lender applies a neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis. This theory generally evaluates the treatment of full groups of prohibited basis and non-prohibited basis pools of customers without individual paper file comparisons. However, loan file reviews may be required to gather relevant data not retained on the Bank's database or to verify electronic data elements.

The FDIC could proceed with a case under any one of these two theories depending on the facts and circumstances.

Since disparate impact theory is based on a neutral policy or practice, my experience indicates this theory is most often used where a disparity in the results of compared groups is noted. The disparity could be related to pricing, underwriting, or loan application patterns. A key component in all the cases I'm aware of was discretion which <u>could have</u> been a factor that produced the raw disparity.

- As an example, a bank has a rate sheet with various adjustments, such as Loan To Value or credit score, but also allows loan officers to deviate from the rate sheet if the loan officer wishes. That ability to use their judgment in pricing is "discretion." If we see a disparity in how the pricing negatively impacted a prohibited basis group, we would gather all data elements that management states it considers in setting the rate, control for these factors, and if the disparity remains, it is evidence the difference in treatment was due to the discretion exercised by the loan officer and not legitimate pricing factors.

The allowed discretion is a policy decision that is neutral on its face, but could have a disparate impact on certain prohibited basis groups. Here are a couple of factors that may help improve your understanding of a disparate impact review.

- We will always provide the bank the opportunity to present all legitimate business factors which they believe explains the difference in treatment noted in the raw data.

We recognize that raw data, such as a HMDA Loan Application Register (or LAR), provides limited information and therefore is only a risk indicator. The underlying components of creditworthiness or pricing factors will be solicited and controlled for in any ongoing statistical analysis.

- A disparate impact violation occurs when a statistically significant disparity remains, and the bank has not supported a legitimate business reason for the neutral practice that caused the disparity.
- You might hear the term 1% or 5% level when discussing statistical significance with FDIC staff. What this means is that under the 1% statistical significance level, the result, or noted disparity, has less than a 1% change of being random.

What you need to know about Disparate Impact:

- Agree with it or not, disparate impact is something you need to understand because it will be considered when evaluating your lending operations. HUD, DOJ, and the Consumer Financial Protection Bureau (also known as the CFPB) have all made it clear to the industry that they see this as a viable theory under which to pursue lending discrimination cases.

- The best management controls you can develop are clear standards that are monitored for consistent application. Evaluate your data and understand how your policies could be impacting the decisions reflected in that data. Again, do not ignore non-HMDA reportable products, such as consumer or home equity lines of credit, when looking at your lending activities.

Throughout the presentation we have identified various types of activities that could heighten a bank’s risk for Fair Lending violations. We would also like to highlight a couple of specific violations on Slides 11 and 12.

On Slide 11 we will discuss signature violations, which we continue to identify.

- These violations result when the bank requests/requires a credit instrument to be signed, in addition to the security document by a non-applicant, non-principal of the business (often a spouse). The collateral that is taken is generally the family residence, but could be any jointly-owned collateral. Prior FDIC reviews have not identified any case law in the states that comprise the New York Region that supports anything beyond just signing the mortgage or other collateral security documents.

    - First, the bank should underwrite the application as it is submitted. Only if the applicant fails to meet the credit standard of the bank can the bank ask for additional parties or collateral.
    - If the bank evaluates jointly-owned collateral, the bank should first determine if the applicant's individual interest in that collateral is adequate before requesting any signature from the non-applicant co-owner.

- Regulation B places responsibility on each bank to understand the unique structure of the marital property laws where it makes loans and only get signatures from non-applicant spouses on credit instruments that are necessary, or reasonably believed to be necessary.

    - The Official Staff Interpretations to Section 1002.7 provides the following which I will quote directly: (quote) "Generally, a signature to make the secured property available will only be needed on a security agreement. A creditor's reasonable belief that, to ensure access to the property, the spouse's signature is needed on an instrument that imposes personal liability should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general." (close quote)

  - Lack of pertinent legal support results in the prohibition against the use of credit instruments in addition to the security documents.

- Banks often state the reason they implemented a practice of getting a limited or full guaranty is because they need to show "consideration," but this belief doesn't displace the standard defined in the Official Staff Interpretations.

- Regulation B does recognize instances where parties may wish to apply jointly. The bank should develop procedures to appropriately document applicant intent to apply jointly in compliance with the guidance provided within Regulation B.

- The 2nd quarter 2013 "Division of Depositor and Consumer Protection – New York Region Newsletter" included a detailed discussion of Spousal Signatures. If you do not receive this newsletter, please submit your request to be added to the distribution list by emailing dcpnewsletterny@fdic.gov.

Moving on to Slide 12, we will discuss pricing-related violations. Pricing discrimination cases continue to occur. As noted previously in this presentation, clear pricing standards, monitored for consistent application and appropriate exceptions is the best control for this type of risk.

- Although cases have been brought relating to residential loans, we also see increasing numbers regarding consumer loans.
- Without ongoing monitoring you will not know for sure what pricing practices are being followed. Pricing violations are almost always linked to discretion in setting the loan rates, including through unmonitored exceptions.

- One of the reasons we see more cases is the advances in automation and regression analysis that makes it feasible to evaluate non-HMDA reportable loans more efficiently.

- o We use census data as an objective standard to help separate non-HMDA loans based on things like gender and ethnicity.

- When evaluating pricing risk, don't limit your review to only the interest rate applied to each customer. While this is important and needs to be monitored, there is also risk within the ability to waive fees at both the origination and servicing stage.

Now to our closing thoughts included on Slide 13:

First, we want to thank you for your time and interest in this topic and hopefully you have found both the content and format beneficial.

We would like to leave you with these points…

- Fair Lending risks will continue to evolve and you are encouraged to monitor trade publications, regulatory bulletins and other issuances, the FDIC Compliance Manual, the DOJ website, and legal decisions for new guidance and cases as they becomes available.

- Know your bank and be sensitive to areas that allow discretion. While judgment is fundamental to being a good loan officer, it also carries Fair Lending risk the bank cannot afford to ignore.

- 3rd parties present significant risks if not properly vetted and monitored.

- On Slide 14 we have included various resource links and our contact information is on Slide 15.

That concludes our prepared remarks from the slide deck. I'll turn the program back over to Regional Director Vogel.

Thank you Joe and Rose. We're now going to start the question and answer session, but first I'd like to acknowledge that there may be questions from some of you that will require some research on our part, or there may be insufficient time to get to all your questions today. You can be assured, however, that any question that isn't fully addressed today will be answered by our staff. All registrants for today's presentation will be provided with responses via email where appropriate.

I'm going to turn the session back over to the operator who will reiterate the procedure for participants to call in your questions. We will also be responding to your email questions received at NYCalls@fdic.gov during the presentation.