Fair Lending Laws and Regulations

Introduction

This overview provides a basic and abbreviated discussion of federal fair lending laws and regulations. It is adapted from the Interagency Policy Statement on Fair Lending issued in March 1994.

Lending Discrimination Statutes and Regulations

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on:

- Race or color;
- Religion;
- National origin;
- Sex;
- Marital status;
- Age (provided the applicant has the capacity to contract);
- The applicant's receipt of income derived from any public assistance program; or
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act.

The Consumer Financial Protection Bureau's Regulation B, found at 12 CFR part 1002, implements the ECOA. Regulation B describes lending acts and practices that are specifically prohibited, permitted, or required. Official staff interpretations of the regulation are found in Supplement I to 12 CFR part 1002.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 further amended the ECOA and covers:

- Data collection for loans to minority-owned and women-owned businesses (awaiting final regulation);
- Legal action statute of limitations for ECOA violations is extended to five years (effective July 21, 2010); and
- A disclosure of the consumer's ability to receive a copy of any appraisal(s) and valuation(s) prepared in connection with first-lien loans secured by a dwelling is to be provided to applicants within 3 business days of receiving the application (effective January 18, 2014).

NOTE: Further information regarding the technical requirements of fair lending are incorporated into the sections ECOA V 7.1 and FCRA VIII 6.1 of this manual.

The Fair Housing Act (FHAct) prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to:

- Making loans to buy, build, repair, or improve a dwelling;
- Purchasing real estate loans;
- Selling, brokering, or appraising residential real estate; or
- Selling or renting a dwelling.

The FHAct prohibits discrimination based on:

- Race or color;
- National origin;
- Religion;
- Sex;
- Familial status (defined as children under the age of 18 living with a parent or legal custodian, pregnant women, and people securing custody of children under 18); or
- Handicap.

The Department of Housing and Urban Development's (HUD) regulations implementing the FHAct are found at 24 CFR Part 100. Because both the FHAct and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending based on any of the prohibited factors in either list.

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FHAct, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of these laws, 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.
- Treat a borrower differently in servicing a loan or invoking default remedies.
- 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 violation may still exist even if a lender treated applicants equally.

A lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower.
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide).
- The present or prospective occupants of either the property to be financed or the characteristics of the neighborhood or other area where property to be financed is located.

Finally, the FHAct requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.

Types of Lending Discrimination

The FDIC evaluates ~~The courts have recognized three methods of proof of lending discrimination~~potential discrimination under the ECOA and the FHAct through:

- Overt evidence of disparate treatment; or
- Comparative evidence of disparate treatment~~; and~~
- ~~Evidence of disparate impact.~~

Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (overt evidence) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (comparative evidence).

Overt Evidence of Disparate Treatment. There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

Example: A lender offered a credit card with a limit of up to $750 for applicants aged 21-30 and $1500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when a lender expresses — but does not act on — a discriminatory preference:

Example: A lending officer told a customer, "We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law." This statement violated the FHAct's prohibition on statements expressing a discriminatory preference as well as Section 1002.4(b) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

Comparative Evidence of Disparate Treatment. Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are "close cases," there is more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the lender provides the applicant in completing an application. The lender may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

Example: A non-minority couple applied for an automobile loan. The lender found adverse information in the couple's credit report. The lender discussed the credit report with them and determined that the adverse information, a judgment against the couple, was incorrect because the judgment had been vacated. The non-minority couple was granted their loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denied the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the lender provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender's explanation is found to be not credible, the agency may find that the lender discriminated.

Redlining is a form of illegal disparate treatment in which a lender 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 violate both the FHAct and the ECOA.

~~**Disparate Impact**~~

~~When a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a "disparate impact."~~

~~**Example:** A lender's policy is not to extend loans for single-family residences for less than $60,000.00. This policy has been in effect for ten 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 fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation. When an Agency finds that a lender's policy or practice has a disparate impact; the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative.~~

~~Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of discriminatory intent is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FHAct or ECOA.~~

~~These procedures do not call for examiners to plan examinations to identify or focus on potential disparate impact issues. The guidance in this Introduction is intended to help examiners recognize fair lending issues that may have a potential disparate impact. Guidance in the **Appendix** to the Interagency Fair Lending Examination Procedures provides details on how to obtain relevant information regarding such situations along with methods of evaluation, as appropriate.~~

General Guidelines

These procedures are intended to be a basic and flexible framework to be used in the majority of fair lending examinations conducted by the FFIEC agencies. They are also intended to guide examiner judgment, not to supplant it. The procedures can be augmented by each agency as necessary to ensure their effective implementation. While these procedures apply to many examinations, agencies routinely use statistical analyses or other specialized techniques in fair lending examinations to assist in evaluating whether a prohibited basis was a factor in an institution's credit decisions. Examiners should follow the procedures provided by their respective agencies in these cases.

For a number of aspects of lending — for example, credit scoring and loan pricing — the "state of the art" is more likely to be advanced if the agencies have some latitude to incorporate promising innovations. These interagency procedures provide for that latitude.

Any references in these procedures to options, judgment, etc., of "examiners" means discretion within the limits provided by that examiner's agency. An examiner should use these procedures in conjunction with his, or her, own agency's priorities, examination philosophy, and detailed guidance for implementing these procedures. These procedures should not be interpreted as providing the examiner greater latitude than his, or her, own agency would. For example, if an agency's policy is to review compliance management systems in all of its institutions, an examiner for that agency must conduct such a review rather than interpret Part II of these interagency procedures as leaving the review to the examiner's option.

The procedures emphasize racial and national origin discrimination in residential transactions, but the key principles are applicable to other prohibited bases and to nonresidential transactions.

Finally, these procedures focus on analyzing institution compliance with the broad, nondiscrimination requirements of the ECOA and the FHAct. They do not address such explicit or technical compliance provisions as the signature rules or adverse action notice requirements in Sections 1002.7 and 1002.9, respectively, of Regulation B.

Part I — Examination Scope Guidelines Background

Consistent with the Federal Financial Institutions Examination Council Interagency Fair Lending Examination Procedures, FDIC examiners evaluate fair lending risk during the scoping process by completing three general steps:

1. Examiners develop an institutional overview to assess an institution's inherent fair lending risk. As part of this process, examiners become familiar with an institution's structure and management, supervisory history, loan portfolio, and credit and market operations. Once examiners understand a financial institution's lending operations they can identify the level of inherent risk. Inherent risk for fair lending is broad-based and would impact a range of products if no controls or other mitigating factors were in place to control the risk. Inherent risk arises from the general

conditions or the environment in which the institution operates. The risk could be present based on an institution's structure, supervisory history, the composition of the loan portfolio, and the credit and market operations

2. If an examiner believes that an institution has more than minimal inherent fair lending risk, the examiner should then identify the product(s) or product group(s) to review. The products or product groups selected may differ based on the type of discrimination. For example, for purposes of pricing, an examiner may select HMDA loans for further review, while for underwriting, the examiner may select consumer loans. Examiners are not expected to review all products for discrimination risk if there is more than minimal inherent risk. Rather, examiners should use their judgment and consider the following when deciding which loan products warrant further review. Examiners would then identify any discrimination risk factors and assess an institution's compliance management system (CMS) for fair lending. Understanding the strength of an institution's CMS is necessary to properly assess whether an institution has sufficiently mitigated applicable discrimination risk factors. If there is minimal inherent risk, no additional analysis is necessary and the fair lending review can conclude.

3. For those discrimination risk factors that have not been fully mitigated, examiners compile a list of potential focal points and identify which should be pursued as a focal point.

The FDIC has developed the Fair Lending Scope and Conclusions Memorandum (FLSC) to implement a standard nationwide format for documenting the scope and conclusions of fair lending reviews. FLSC has been adopted as a means of focusing the examiner's attention to the areas that pose the greatest unmanaged fair lending risk to the institution. It incorporates the Interagency Fair Lending Examination Procedures[1] and assists in documenting the types of fair lending risks that are present; the controls that management has put in place to manage the risk; the effectiveness of these controls; why the particular focal point(s) are chosen; the level of review conducted; and the results of any additional analysis that was conducted. The FLSC is included in section IV-3.1 of this manual.

The scope of an examination encompasses the loan product(s), market(s), decision center(s), time frame, and prohibited basis and control group(s) to be analyzed during the examination. These procedures refer to each potential combination of those elements as a "focal point." Setting the scope of an examination involves, first, identifying all of the potential focal points that appear worthwhile to examine. Then, from among those, examiners select the **Focal Point(s)** that will form the scope of the examination, based on risk factors, priorities established in these procedures or by their respective agencies, the record from past examinations, and other relevant guidance. This phase includes obtaining an overview of an institution's compliance management system as it relates to fair lending.

When selecting focal points for review, examiners may determine that the institution has performed "self-tests" or "self-evaluations" related to specific lending products. The difference between "self-tests" and "self-evaluations" is discussed in the *Using Self-Tests and Self-Evaluations to Streamline the Examination* section of the **Appendix**. Institutions must share all information regarding "self-evaluations" and certain limited information related to "self-tests." Institutions may choose to voluntarily disclose additional information about "self-tests." Examiners should make sure that institutions understand that voluntarily sharing the results of self-tests will result in a loss of confidential status of these tests. Information from "self-evaluations" or "self-tests" may allow the scoping to be streamlined. Refer to *Using Self-Tests and Self-Evaluations to Streamline the Examination* in the **Appendix** for additional details.

Scoping may disclose the existence of circumstances — such as the use of credit scoring or a large volume of residential lending — which, under an agency's policy, call for the use of regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products. Where that is the case, the agency's specialized procedures should be employed for such loan products rather than the procedures set forth below.

Setting the intensity of an examination means determining the breadth and depth of the analysis that will be conducted on the selected loan product(s). This process entails a more involved analysis of the institution's compliance risk management processes, particularly as it relates to selected products, to reach an informed decision regarding how large a sample of files to review in any transactional analyses performed and whether certain aspects of the credit process deserve heightened scrutiny.

Part I of these procedures provides guidance on establishing the scope of the examination. Part II (Compliance Management Review) provides guidance on determining the intensity of the examination. There is naturally some interdependence between these two phases. Ultimately the scope and intensity of the examination will determine the record of performance that serves as the foundation for agency conclusions about institutional compliance with fair lending obligations. The examiner should employ these procedures to arrive at a well-reasoned and practical conclusion about how to conduct a particular institution's examination of fair lending performance.

[1] The interagency examination procedures are presented in their entirety in Part III of this section of the manual.

In certain cases where an agency already possesses information which provides examiners with guidance on priorities and risks for planning an upcoming examination, such information may expedite the scoping process and make it unnecessary to carry out all of the steps below. For example, the report of the previous fair lending examination may have included recommendations for the focus of the next examination. However, examiners should validate that the institution's operational structure, product offerings, policies, and risks have not changed since the prior examination before condensing the scoping process.

The scoping process can be performed either off-site, onsite, or both, depending on whatever is determined appropriate and feasible. In the interest of minimizing burdens on both the examination team and the institution, requests for information from the institution should be carefully thought out so as to include only the information that will clearly be useful in the examination process. Finally, any off-site information requests should be made sufficiently in advance of the on-site schedule to permit institutions adequate time to assemble necessary information and provide it to the examination team in a timely fashion. (*See* "**Potential Scoping Information**" in the **Appendix** for guidance on additional information that the examiner might wish to consider including in a request).

Examiners should focus the examination based on:

- An understanding of the credit operations of the institution;
- The risk that discriminatory conduct may occur in each area of those operations; and
- The feasibility of developing a factually reliable record of an institution's performance and fair lending compliance in each area of those operations.

Understanding Credit Operations

Before evaluating the potential for discriminatory conduct, the examiner should review sufficient information about the institution and its market to understand the credit operations of the institution and the representation of prohibited basis group residents within the markets where the institution does business. The level of detail to be obtained at this stage should be sufficient to identify whether any of the risk factors in the steps below are present. Relevant background information includes:

- The types and terms of credit products offered, differentiating among broad categories of credit such as residential, consumer, or commercial, as well as product variations within such categories (fixed vs. variable, etc.).
- Whether the institution has a special purpose credit program, or other program that is specifically designed to assist certain underserved populations.
- The volume of, or growth in, lending for each of the credit products offered.
- The demographics (i.e., race, national origin, etc.) of the credit markets in which the institution is doing business.
- The institution's organization of its credit decision-making process, including identification of the delegation of separate lending authorities and the extent to which discretion in pricing or setting credit terms and conditions is delegated to various levels of managers, employees or independent brokers or dealers.
- The institution's loan officer or broker compensation program.
- The types of relevant documentation/data that are available for various loan products and what is the relative quantity, quality and accessibility of such information (i.e., for which loan product(s) will the information available be most likely to support a sound and reliable fair lending analysis).
- The extent to which information requests can be readily organized and coordinated with other compliance examination components to reduce undue burden on the institution. (Do not request more information than the exam team can be expected to utilize during the anticipated course of the examination.)

In thinking about an institution's credit markets, the examiner should recognize that these markets may or may not coincide with an institution's Community Reinvestment Act (CRA) assessment area(s). Where appropriate, the examiner should review the demographics for a broader geographic area than the assessment area.

Where an institution has multiple underwriting or loan processing centers or subsidiaries, each with fully independent credit-granting authority, consider evaluating each center and/or subsidiary separately, provided a sufficient number of loans exist to support a meaningful analysis. In determining the scope of the examination for such institutions, examiners should consider whether:

- Subsidiaries should be examined. The agencies will hold a financial institution responsible for violations by its direct subsidiaries, but not typically for those by its affiliates (unless the affiliate has acted as the agent for the institution or the violation by the affiliate was known or should have been known to the institution before it became involved in the transaction or purchased the affiliate's loans). When seeking to determine an institution's relationship with affiliates that are not supervised financial institutions, limit the inquiry to what can be learned in the institution and do not contact the

affiliate without prior consultation with agency staff.

- The underwriting standards and procedures used in the entity being reviewed are used in related entities not scheduled for the planned examination. This will help examiners to recognize the potential scope of policy-based violations.
- The portfolio consists of applications from a purchased institution. If so, for scoping purposes, examiners should consider the applications as if they were made to the purchasing institution. *For comparison purposes, applications evaluated under the purchased institution's standards should not be compared to applications evaluated under the purchasing institution's standards*.
- The portfolio includes purchased loans. If so, examiners should look for indications that the institution specified loans to purchase based on a prohibited factor or caused a prohibited factor to influence the origination process.
- A complete decision can be made at one of the several underwriting or loan processing centers, each with independent authority. In such a situation, it is best to conduct on-site a separate comparative analysis at each underwriting center. If covering multiple centers is not feasible during the planned examination, examiners should review their processes and internal controls to determine whether or not expanding the scope and/or length of the examination is justified.
- Decision-making responsibility for a single transaction may involve more than one underwriting center. For example, an institution may have authority to decline mortgage applicants, but only the mortgage company subsidiary may approve them. In such a situation, examiners should learn which standards are applied in each entity and the location of records needed for the planned comparisons.
- Applicants can be steered from the financial institution to the subsidiary or other lending channel and vice versa, and what policies and procedures exist to monitor this practice.
- Any third parties[2], such as brokers or contractors, are involved in the credit decision and how responsibility is allocated among them and the institution. The institution's familiarity with third party actions may be important, for an institution may be in violation if it participates in transactions in which it knew or reasonably ought to have known other parties were discriminating.

As part of understanding the financial institution's own lending operations, it is also important to understand any dealings the financial institution has with affiliated and non-affiliated mortgage loan brokers and other third party lenders.

These brokers may generate mortgage applications and originations solely for a specific financial institution or may broadly gather loan applications for a variety of local, regional, or national lenders. As a result, it is important to recognize what impact these mortgage brokers and other third party lender actions and application processing operations have on the lending operations of a financial institution. Because brokers can be located anywhere in or out of the financial institution's primary lending or CRA assessment areas, it is important to evaluate broker activity and fair lending compliance related to underwriting, terms, and conditions, redlining, and steering, each of which is covered in more depth in sections of these procedures. Examiners should consult with their respective agencies for specific guidance regarding broker activity.

If the institution is large and geographically diverse, examiners should select only as many markets or underwriting centers as can be reviewed readily in depth, rather than selecting proportionally to cover every market. As needed, examiners should narrow the focus to the Metropolitan Statistical Area (MSA) or underwriting center(s) that are determined to present the highest discrimination risk. Examiners should use Loan Application Register (LAR) data organized by underwriting center, if available. After calculating denial rates between the control and prohibited basis groups for the underwriting centers, examiners should select the centers with the highest fair lending risk. This approach would also be used when reviewing pricing or other terms and conditions of approved applicants from the prohibited basis and control groups. If underwriting centers have fewer than five racial or national origin denials, examiners should not examine for racial discrimination in underwriting. Instead, they should shift the focus to other loan products or prohibited bases, or examination types such as a pricing examination.

However, if examiners learn of other indications of risks that favor analyzing a prohibited basis with fewer transactions than the minimum in the sample size tables, they should consult with their supervisory office on possible alternative methods of analysis. For example, there is strong reason to examine a pattern in which almost all of 19 male borrowers received low rates but almost all of four female borrowers received high rates, even though the number of each group is fewer than the stated minimum. Similarly, there would be strong reason to examine a pattern in which almost all of 100 control group applicants were approved but all four

[2] See FDIC Financial Institution Letter (FIL), FIL-3-2021 *FDIC Adopts Rule on the Role of Supervisory Guidance*; FIL-29-2023 *Interagency Guidance on Third-Party Relationships: Risk Management*; Part 364 – *Standards for Safety and Soundness*; and FIL-5-2015 *Statement on Providing Banking Services.*

prohibited basis group applicants were not, even though the number of prohibited basis denials was fewer than five.

Evaluating the Potential for Discriminatory Conduct

Step One: Develop an Overview

Based on his or her understanding of the credit operations and product offerings of an institution, an examiner should determine the nature and amount of information required for the scoping process and should obtain and organize that information. No single examination can reasonably be expected to evaluate compliance performance as to every prohibited basis, in every product, or in every underwriting center or subsidiary of an institution. In addition to information gained in the process of Understanding Credit Operations, above, the examiner should keep in mind the following factors when selecting products for the scoping review:

- Which products and prohibited bases were reviewed during the most recent prior examination(s) and, conversely, which products and prohibited bases have not recently been reviewed?
- Which prohibited basis groups make up a significant portion of the institution's market for the different credit products offered?
- Which products and prohibited basis groups the institution reviewed using either a voluntarily disclosed self-test or a self-evaluation?

Based on consideration of the foregoing factors, the examiner should request information for all residential and other loan products considered appropriate for scoping in the current examination cycle. In addition, wherever feasible, examiners should conduct preliminary interviews with the institution's key underwriting personnel and those involved with establishing the institution's pricing policies and practices. Using the accumulated information, the examiner should evaluate the following, as applicable:

- Underwriting guidelines, policies, and standards.
- Descriptions of credit scoring systems, including a list of factors scored, cutoff scores, extent of validation, and any guidance for handling overrides and exceptions. (Refer to Part A of the "Considering Automated Underwriting and Credit Scoring" section of the **Appendix** for guidance.)
- Applicable pricing policies, risk-based pricing models, and guidance for exercising discretion over loan terms and conditions.
- Descriptions of any compensation system, including whether compensation is related to, loan production or pricing.
- The institution's formal and informal relationships with any finance companies, subprime mortgage or consumer lending entities, or similar institutions.
- Loan application forms.
- Home Mortgage Disclosure Act – Loan Application Register (HMDA-LAR) or loan registers and lists of declined applications.
- Description(s) of databases maintained for loan product(s) to be reviewed.
- Records detailing policy exceptions or overrides, exception reporting and monitoring processes.
- Copies of any consumer complaints alleging discrimination and related loan files.
- Compliance program materials (particularly fair lending policies), training manuals, organization charts, as well as record keeping, monitoring protocols, and internal controls.
- Copies of any available marketing materials or descriptions of current or previous marketing plans or programs or pre-screened solicitations.

Step Two: Identify Compliance Program Discrimination Risk Factors

Review information from agency examination work papers, institutional records and any available discussions with management representatives in sufficient detail to understand the organization, staffing, training, recordkeeping, auditing, policies and procedures of the institution's fair lending compliance systems. Review these systems and note the following risk factors:

C1. Overall institution compliance record is weak.

C2. Prohibited basis monitoring information required by applicable laws and regulations is nonexistent or incomplete.

C3. Data and/or recordkeeping problems compromised reliability of previous examination reviews.

C4. Fair lending problems were previously found in one or more institution products or in institution subsidiaries.

C5. The size, scope, and quality of the compliance management program, including management's involvement, designation of a compliance officer, and staffing is materially inferior to programs customarily found in institutions of similar size, market demographics, and credit complexity.

C6. The institution has not updated compliance policies and procedures to reflect changes in law or in agency guidance.

C7. Fair lending training is nonexistent or weak.

Consider these risk factors and their impact on particular lending products and practices as you conduct the product specific risk review during the scoping steps that follow. Where this review identifies fair lending compliance system deficiencies, give them appropriate consideration as part of the Compliance Management Review in Part II of these procedures.

Step Three: Review Residential Loan Products

Although home mortgages may not be the ultimate subject of every fair lending examination, this product line must at least be considered in the course of scoping every institution that is engaged in the residential lending market.

Divide home mortgage loans into the following groupings: home purchase, home improvement, and refinancings. Subdivide those three groups further if an institution does a significant number of any of the following types or forms of residential lending, and consider them separately:

- Government-insured loans
- Mobile home or manufactured housing loans
- Wholesale, indirect, and brokered loans
- Portfolio lending (including portfolios of Fannie Mae/Freddie Mac rejections)

In addition, determine whether the institution offers any conventional "affordable" housing loan programs special purpose credit programs or other programs that are specifically designed to assist certain borrowers, such as underserved populations and whether their terms and conditions make them incompatible with regular conventional loans for comparative purposes. If so, consider them separately.

If previous examinations have demonstrated the following, then an examiner may limit the focus of the current examination to alternative underwriting or processing centers or to other residential products that have received less scrutiny in the past:

- A strong fair lending compliance program.
- No record of discriminatory transactions at particular decision centers or in particular residential products.
- No indication of a significant change in personnel, operations, or underwriting or pricing policies at those centers or in those residential products.
- No unresolved fair lending complaints, administrative proceedings, litigation, or similar factors.
- No discretion to set price or credit terms and conditions in particular decision centers or for particular residential products.

Step Four: Identify Residential Lending Discrimination Risk Factors

Review the lending policies, marketing plans, underwriting, appraisal and pricing guidelines, broker/agent agreements and loan application forms for each residential loan product that represents an appreciable volume of, or displays noticeable growth in, the institution's residential lending.

- Review also any available data regarding the geographic distribution of the institution's loan originations with respect to the race and national origin percentages of the census tracts within its assessment area or, if different, its residential loan product lending area(s).
- Conduct interviews of loan officers and other employees or agents in the residential lending process concerning adherence to and understanding of the above policies and guidelines as well as any relevant operating practices.
- In the course of conducting the foregoing inquiries, look for the following risk factors (factors are numbered alphanumerically to coincide with the type of factor, e.g., "O" for "overt"; "P" for "pricing," etc.).

***NOTE**: For risk factors below that are marked with an asterisk (*), examiners need not attempt to calculate the indicated ratios for racial or national origin characteristics when the institution is not a HMDA reporter. However, consideration should be given in such cases to whether or not such calculations should be made based on gender or racial-ethnic surrogates.*

***Overt** indicators of discrimination such as:*

O1. Including explicit prohibited basis identifiers in the institution's written or oral policies and procedures (underwriting criteria, pricing standards, etc.).

O2. Collecting information, conducting inquiries or imposing conditions contrary to express requirements of Regulation B.

O3. Including variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FHAct. (If a credit scoring system scores age, refer to *Part E* of the *Considering Automated Underwriting and Credit Scoring* section of the **Appendix**.)

O4. Statements made by the institution's officers, employees, or agents which constitute an express or implicit indication that one or more such persons have engaged or do engage in discrimination on a prohibited basis in any aspect of a credit transaction.

O5. Employee or institutional statements that evidence

attitudes based on prohibited basis prejudices or stereotypes.

Indicators of potential ***disparate treatment in Underwriting*** *such as:*

U1. *Substantial disparities among the approval/denial rates for applicants by monitored prohibited basis characteristic (especially within income categories).

U2. *Substantial disparities among the application processing times for applicants by monitored prohibited basis characteristic (especially within denial reason groups).

U3. *Substantially higher proportion of withdrawn/ incomplete applications from prohibited basis group applicants than from other applicants.

U4. Vague or unduly subjective underwriting criteria.

U5. Lack of clear guidance on making exceptions to underwriting criteria, including credit scoring overrides.

U6. Lack of clear loan file documentation regarding reasons for any exceptions to standard underwriting criteria, including credit scoring overrides.

U7. Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs.

U8. Loan officer or broker compensation based on loan volume (especially loans approved per period of time).

U9. Consumer complaints alleging discrimination in loan processing or in approving/denying residential loans.

Indicators of potential ***disparate treatment in Pricing*** *(interest rates, fees, or points) such as:*

P1. Financial incentives for loan officers or brokers to charge higher prices (including interest rate, fees and points). Special attention should be given to situations where financial incentives are accompanied by broad pricing discretion (as in P2), such as through the use of overages or yield spread premiums.

P2. Presence of broad discretion in loan pricing (including interest rate, fees and points), such as through overages, underages or yield spread premiums. Such discretion may be present even when institutions provide rate sheets and fees schedules, if loan officers or brokers are permitted to deviate from those rates and fees without clear and objective criteria.

P3. Use of risk-based pricing that is not based on objective criteria or applied consistently.

P4. *Substantial disparities among prices being quoted or charged to applicants who differ as to their monitored prohibited basis characteristics.

P5. Consumer complaints alleging discrimination in residential loan pricing.

P6. *In mortgage pricing, disparities in the incidence or rate spreads[3] of higher-priced lending by prohibited basis characteristics as reported in the HMDA data.

P7. *A loan program that contains only borrowers from a prohibited basis group, or has significant differences in the percentages of prohibited basis groups, especially in the absence of a Special Purpose Credit Program under ECOA.

Indicators of potential ***disparate treatment by Steering*** *such as:*

S1. Lack of clear, objective and consistently implemented standards for (i) referring applicants to subsidiaries, affiliates, or lending channels within the institution (ii) classifying applicants as "prime" or "sub-prime" borrowers, or (iii) deciding what kinds of alternative loan products should be offered or recommended to applicants (product placement).

S2. Financial incentives for loan officers or brokers to place applicants in nontraditional products (i.e., negative amortization, "interest only", "payment option" adjustable rate mortgages) or higher cost products.

S3. 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.

S4. *Significant differences in the percentage of prohibited basis applicants in loan products or products with specific features relative to control group applicants. Special attention should be given to products and features that have potentially negative consequences for applicants (i.e., non-traditional mortgages, prepayment penalties, lack of escrow requirements, or credit life insurance).

S5. *For an institution that has one or more sub-prime mortgage subsidiaries or affiliates, any significant differences, by loan product, in the percentage of prohibited basis applicants of the institution compared to the percentage of prohibited basis applicants of the subsidiary(ies) or affiliate(s).

S6. *For an institution that has 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.

[3] Regulation C, Section 203.4(a)(12)

S7. Consumer complaints alleging discrimination in residential loan pricing or product placement.

S8. *For an institution with sub-prime mortgage subsidiaries, a concentration of those subsidiaries' branches in minority areas relative to its other branches.

*Indicators of potential **discriminatory Redlining** such as:*

R1. *Significant differences, as revealed in HMDA data, 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 compared with areas with relatively low concentrations of minority residents.

R2. *Significant differences between approval/denial rates for all applicants (minority and non-minority) in areas with relatively high concentrations of minority group residents compared with areas with relatively low concentrations of minority residents.

R3. *Significant differences between denial rates based on insufficient collateral for applicants from areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.

R4. *Significant differences in the number of originations of higher-priced loans or loans with potentially negative consequences for borrowers, (i.e., non-traditional mortgages, prepayment penalties, lack of escrow requirements) in areas with relatively high concentrations of minority residents compared with areas with relatively low concentrations of minority residents.

R5. Other patterns of lending identified during the most recent CRA examination that differ by the concentration of minority residents.

R6. 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.

R7. Difference in services available or hours of operation at branch offices located in areas with concentrations of minority residents when compared to branch offices located in areas with concentrations of non-minority residents.

R8. Policies on receipt and processing of applications, pricing, conditions, or appraisals and valuation, or on any other aspect of providing residential credit that vary between areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.

R9. The institution's CRA assessment area appears to have been drawn to exclude areas with relatively high concentrations of minority residents.

R10. Employee statements that reflect an aversion to doing business in areas with relatively high concentrations of minority residents.

R11. Complaints or other allegations by consumers or community representatives that the institution excludes or restricts access to credit for areas with relatively high concentrations of minority residents. Examiners should review complaints against the institution filed either with their agency or the institution; the CRA public comment file; community contact forms; and the responses to questions about redlining, discrimination, and discouragement of applications, and about meeting the needs of racial or national origin minorities, asked as part of obtaining local perspectives on the performance of financial institutions during prior CRA examinations.

R12. An institution that has most of its branches in predominantly non-minority neighborhoods at the same time that the institution's sub-prime mortgage subsidiary has branches which are located primarily in predominantly minority neighborhoods.

*Indicators of potential **disparate treatment in Marketing** of residential products, such as:*

M1. Advertising patterns or practices that a reasonable person would believe indicate prohibited basis customers are less desirable.

M2. Advertising only in media serving non-minority areas of the market.

M3. Marketing through brokers or other agents that the institution knows (or has reason to know) would serve only one racial or ethnic group in the market.

M4. Use of marketing programs or procedures for residential loan products that exclude one or more regions or geographies within the institutions assessment or marketing area that have significantly higher percentages of minority group residents than does the remainder of the assessment or marketing area.

M5. Using mailing or other distribution lists or other marketing techniques for pre-screened or other offerings of residential loan products that:

- Explicitly exclude groups of prospective borrowers on a prohibited basis; or
- Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have significantly higher percentages of minority group residents than does the remainder of the marketing area.

M6. *Proportion of prohibited basis applicants is significantly lower than that group's representation in the total population of the market area.

M7. Consumer complaints alleging discrimination in advertising or marketing loans.

Step Five: Organize and Focus Residential Risk Analysis

Review the risk factors identified in Step 4 and, for each loan product that displays risk factors, articulate the possible discriminatory effects encountered and organize the examination of those loan products in accordance with the following guidance. For complex issues regarding these factors, consult with agency supervisory staff.

- Where overt evidence of discrimination, as described in factors O1-O5, has been found in connection with a product, document those findings as described in Part III, B, besides completing the remainder of the planned examination analysis.
- Where any of the risk factors U1-U9 are present, consider conducting an underwriting comparative file analysis as described in Part III, C.
- Where any of the risk factors P1-P7 are present, consider conducting a pricing comparative file analysis as described in Part III, D.
- Where any of the risk factors S1-S8 are present, consider conducting a steering analysis as described in Part III, E.
- Where any of the risk factors R1-R12 are present, consider conducting an analysis for redlining as described in Part III, G.
- Where any of the risk factors M1-M7 are present, consider conducting a marketing analysis as described in Part III, H.
- Where an institution uses age in any credit scoring system, consider conducting an examination analysis of that credit scoring system's compliance with the requirements of Regulation B as described in Part III, I.

Step Six: Identify Consumer Lending Discrimination Risk Factors

For any consumer loan products selected in Step One for risk analysis, examiners should conduct a risk factor review similar to that conducted for residential lending products in Steps Three through Five, above. Examiners should consult with agency supervisory staff regarding the potential use of surrogates to identify possible prohibited basis group individuals.

***NOTE**: The term surrogate in this context refers to any factor related to a loan applicant that potentially identifies that applicant's race, color, or other prohibited basis characteristic in instances where no direct evidence of that characteristic is available. Thus, in consumer lending, where monitoring data is generally unavailable, a Hispanic or Asian surname could constitute a surrogate for an applicant's race or national origin because the examiner can assume that the institution (which can rebut the presumption) perceived the person to be Hispanic or Asian. Similarly, an applicant's given name could serve as a surrogate for his or her gender. A surrogate for a prohibited basis group characteristic may be used to set up a comparative analysis with control group applicants or borrowers.*

Examiners should then follow the rules in Steps Three through Five, above and identify the possible discriminatory patterns encountered and consider examining those products determined to have sufficient risk of discriminatory conduct.

Step Seven: Identify Commercial Lending Discrimination Risk Factors

Where an institution does a substantial amount of lending in the commercial lending market, most notably small business lending and the product has not recently been examined or the underwriting standards have changed since the last examination of the product, the examiner should consider conducting a risk factor review similar to that performed for residential lending products, as feasible, given the limited information available. Such an analysis should generally be limited to determining risk potential based on risk factors U4- U8; P1-P3; R5-R7; and M1-M3.

If the institution makes commercial loans insured by the Small Business Administration (SBA), determine from agency supervisory staff whether SBA loan data (which codes race and other factors) are available for the institution and evaluate those data pursuant to instructions accompanying them.

For large institutions reporting small business loans for CRA purposes and where the institution also voluntarily geocodes loan denials, look for material discrepancies in ratios of approval-to-denial rates for applications in areas with high concentrations of minority residents compared to areas with concentrations of non-minority residents.

Articulate the possible discriminatory patterns identified and consider further examining those products determined to have sufficient risk of discriminatory conduct in accordance with the procedures for commercial lending described in Part III, F.

Step Eight: Complete the Scoping Process

To complete the scoping process, the examiner should review the results of the preceding steps and select those focal points that warrant examination, based on the relative risk levels identified above. In order to remain within the

agency's resource allowances, the examiner may need to choose a smaller number of focal points from among all those selected on the basis of risk. In such instances, set the scope by first, prioritizing focal points on the basis of (i) high number and/or relative severity of risk factors; (ii) high data quality and other factors affecting the likelihood of obtaining reliable examination results; (iii) high loan volume and the likelihood of widespread risk to applicants and borrowers; and (iv) low quality of any compliance program and, second, selecting for examination review as many focal points as resources permit.

Where the judgment process among competing focal points is a close call, information learned in the phase of conducting the compliance management review can be used to further refine the examiner's choices.

Part II — Compliance Management Review

The Compliance Management Review enables the examination team to determine:

- The intensity of the current examination based on an evaluation of the compliance management measures employed by an institution.
- The reliability of the institution's practices and procedures for ensuring continued fair lending compliance.

Generally, the review should focus on:

- Determining whether the policies and procedures of the institution enable management to prevent, or to identify and self-correct, illegal disparate treatment in the transactions that relate to the products and issues identified for further analysis under Part I of these procedures.
- Obtaining a thorough understanding of the manner by which management addresses its fair lending responsibilities with respect to (a) the institution's lending practices and standards, (b) training and other application-processing aids, (c) guidance to employees or agents in dealing with customers, and (d) its marketing or other promotion of products and services.

To conduct this review, examiners should consider institutional records and interviews with appropriate management personnel in the lending, compliance, audit, and legal functions. The examiner should also refer to the *Compliance Management Analysis Checklist* contained in the **Appendix** to evaluate the strength of the compliance programs in terms of their capacity to prevent, or to identify and self- correct, fair lending violations in connection with the products or issues selected for analysis. Based on this evaluation:

- Set the intensity of the transaction analysis by minimizing sample sizes within the guidelines established in Part III and the *Fair Lending Sample Size Tables* in the **Appendix**, to the extent warranted by the strength and thoroughness of the compliance programs applicable to those focal points selected for examination.
- Identify any compliance program or system deficiencies that merit correction or improvement and present these to management in accordance with Part IV of these procedures.

Where an institution performs a self-evaluation or has voluntarily disclosed the report or results of a self-test of any product or issue that is within the scope of the examination and has been selected for analysis pursuant to Part I of these procedures, examiners may streamline the examination, consistent with agency guidance, provided the self-test or self-evaluation meets the requirements set forth in *Using Self-Tests and Self-Evaluations to Streamline the Examination* located in the **Appendix**.

Part III — Examination Procedures[4]

Once the scope and intensity of the examination have been determined, assess the institution's fair lending performance by applying the appropriate procedures that follow to each of the examination focal points already selected.

A. Verify Accuracy of Data

Prior to any analysis and preferably before the scoping process, examiners should assess the accuracy of the data being reviewed. Data verifications should follow specific protocols (sampling, size, etc.) intended to ensure the validity of the review. For example, where an institution's LAR data is relied upon, examiners should generally validate the accuracy of the institution's submitted data by selecting a sample of LAR entries and verifying that the information noted on the LAR was reported according to instructions by comparing information contained in the loan file for each sampled loan. If the LAR data are inconsistent with the information contained in the loan files, depending on the nature of the errors, examiners may not be able to proceed with a fair lending analysis until the LAR data have been corrected by the institution. In cases where inaccuracies impede the examination, examiners should direct the institution to take action to ensure data integrity (data scrubbing, monitoring, training, etc.).

***NOTE**: While the procedures refer to the use of HMDA data, other data sources should be considered, especially in the case of non-HMDA reporters or institutions that originate loans but are not required to report them on a LAR.*

B. Documenting Overt Evidence of Disparate Treatment

[4] This reflects the interagency examination procedures in their entirety.

Where the scoping process or any other source identifies overt evidence of disparate treatment, the examiner should assess the nature of the policy or statement and the extent of its impact on affected applicants by conducting the following analysis.

Step 1. Where the indicator(s) of overt discrimination are found in or based on a written policy (for example, a credit scorecard) or communication, determine and document:

a. The precise language of the apparently discriminatory policy or communication and the nature of the fair lending concerns that it raises.

b. The institution's stated purpose in adopting the policy or communication and the identity of the person on whose authority it was issued or adopted.

c. How and when the policy or communication was put into effect.

d. How widely the policy or communication was applied.

e. Whether and to what extent applicants were adversely affected by the policy or communication.

Step 2**. Where* ***any indicator of overt discrimination was an oral statement or unwritten practice, determine and document:

a. The precise nature of both the statement, or practice, and of the fair lending concerns that they raise.

b. The identity of the persons making the statement or applying the practice and their descriptions of the reasons for it and the persons authorizing or directing the use of the statement or practice.

c. How and when the statement or practice was disseminated or put into effect.

d. How widely the statement or practice was disseminated or applied.

e. Whether and to what extent applicants were adversely affected by the statement or practice.

Assemble findings and supporting documentation for presentation to management in connection with Part IV of these procedures.

C. Transactional Underwriting Analysis — Residential and Consumer Loans.

Step 1. Set Sample Size

a. For each focal point selected for this analysis, two samples will be utilized: (i) prohibited basis group denials and (ii) control group approvals, both identified either directly from monitoring information in the case of residential loan applications or through the use of application data or surrogates in the case of consumer applications.

b. Refer to *Fair Lending Sample Size Tables*, Table A in the **Appendix** and determine the size of the initial sample for each focal point, based on the number of prohibited basis group denials and the number of control group approvals by the institution during the twelve month (or calendar year) period of lending activity preceding the examination.

In the event that the number of denials and/or approvals acted on during the preceding 12 month period substantially exceeds the maximum sample size shown in Table A, reduce the time period from which that sample is selected to a shorter period. (In doing so, make every effort to select a period in which the institution's underwriting standards are most representative of those in effect during the full 12 month period preceding the examination.)

c. If the number of prohibited basis group denials or control group approvals for a given focal point that were acted upon during the 12 month period referenced in 1.b., above, do not meet the minimum standards set forth in the Sample Size Table, examiners need not attempt a transactional analysis for that focal point. Where other risk factors favor analyzing such a focal point, consult with agency supervisory staff on possible alternative methods of judgmental comparative analysis.

d. If agency policy calls for a different approach to sampling (e.g., a form of statistical analysis, a mathematical formula, or an automated tool) for a limited class of institutions, examiners should follow that approach.

Step 2. Determine Sample Composition

a. To the extent the institution maintains records of loan outcomes resulting from exceptions to its credit underwriting standards or other policies (e.g., overrides to credit score cutoffs), request such records for both approvals and denials, sorted by loan product and branch or decision center, if the institution can do so. Include in the initial sample for each focal point all exceptions or overrides applicable to that focal point.

b. Using HMDA/LAR data or, for consumer loans, comparable loan register data to the extent available, choose approved and denied applications based on selection criteria that will maximize the likelihood of finding marginal approved and denied applicants, as discussed below.

c. To the extent that the above factors are inapplicable or other selection criteria are unavailable or do not

facilitate selection of the entire sample size of files, complete the initial sample selection by making random file selections from the appropriate sample categories in the Sample Size Table.

Step 3. Compare Approved and Denied Applications

Overview: Although a creditor's written policies and procedures may appear to be nondiscriminatory, lending personnel may interpret or apply policies in a discriminatory manner. In order to detect any disparate treatment among applicants, the examiner should first eliminate all but "marginal transactions" (see 3.b. below) from each selected focal point sample. Then, a detailed profile of each marginal applicant's qualifications, the level of assistance received during the application process, the reasons for denial, the loan terms, and other information should be recorded on an Applicant Profile Spreadsheet. Once profiled, the examiner can compare the target and control groups for evidence that similarly qualified applicants have been treated differently as to either the institution's credit decision or the quality of assistance provided.

a. Create Applicant Profile Spreadsheet

Based upon the institution's written and/or articulated credit standards and loan policies, identify categories of data that should be recorded for each applicant and provide a field for each of these categories on a worksheet or computerized spreadsheet. Certain data (income, loan amount, debt, etc.) should always be included in the spreadsheet, while the other data selected will be tailored for each loan product and institution based on applicable underwriting criteria and such issues as branch location and underwriter. Where credit bureau scores and/or application scores are an element of the institution's underwriting criteria (or where such information is regularly recorded in loan files, whether expressly used or not), include a data field for this information in the spread sheet.

In order to facilitate comparisons of the quality of assistance provided to target and control group applicants, respectively, every work sheet should provide a "comments" block appropriately labeled as the site for recording observations from the file or interviews regarding how an applicant was, or was not, assisted in overcoming credit deficiencies or otherwise qualifying for approval.

b. Complete Applicant Profiles

From the application files sample for each focal point, complete applicant profiles for selected denied and approved applications as follows:

- A principal goal is to identify cases where similarly qualified prohibited basis and control group applicants had different credit outcomes, because the agencies have found that discrimination, including differences in granting assistance during the approval process, is more likely to occur with respect to applicants who are not either clearly qualified or unqualified (i.e., "marginal" applicants). The examiner-in-charge should, during the following steps, judgmentally select from the initial sample only those denied and approved applications which constitute marginal transactions. (See **Appendix** on *Identifying Marginal Transactions* for guidance)
- If few marginal control group applicants are identified from the initial sample, review additional files of approved control group applicants. This will either increase the number of marginal approvals or confirm that marginal approvals are so infrequent that the marginal denials are unlikely to involve disparate treatment.
- The judgmental selection of both marginal-denied and marginal-approved applicant loan files should be done together, in a "back and forth" manner, to facilitate close matches and a more consistent definition of "marginal" between these two types of loan files.
- Once the marginal files have been identified, the data elements called for on the profile spreadsheet are extracted or noted and entered.
- While conducting the preceding step, the examiner should simultaneously look for and document on the spreadsheet any evidence found in marginal files regarding the following:
  - the extent of any assistance, including both affirmative aid and waivers or partial waivers of credit policy provisions or requirements, that appears to have been provided to marginal-approved control group applicants which enabled them to overcome one or more credit deficiencies, such as excessive debt-to-income ratios; and
  - the extent to which marginal-denied target group applicants with similar deficiencies were, or were not, provided similar affirmative aid, waivers or other forms of assistance.

c. Review and Compare Profiles

- For each focal point, review all marginal profiles to determine if the underwriter followed institution lending policies in denying applications and whether the reason(s) for denial were supported by facts documented in the loan file and properly disclosed to the applicant pursuant to Regulation B. If any (a) unexplained deviations from credit standards, (b) inaccurate reasons for denial or (c) incorrect disclosures are noted, (whether in a judgmental underwriting system, a scored

system or a mixed system) the examiner should obtain an explanation from the underwriter and document the response on an appropriate workpaper.

NOTE: In constructing the applicant profiles to be compared, examiners must adjust the facts compared so that assistance, waivers, or acts of discretion are treated consistently between applicants. For example, if a control group applicant's DTI ratio was lowered to 42% because the institution decided to include short-term overtime income and a prohibited basis group applicant who was denied due to "insufficient income" would have had his ratio drop from 46% to 41% if his short-term overtime income had been considered, then the examiners should consider 41%, not 46%, in determining the benchmark.

- For each reason for denial identified within the target group, rank the denied prohibited basis applicants, beginning with the applicant whose qualification(s) related to that reason for denial were least deficient. (The top-ranked denied applicant in each such ranking will be referred to below as the "benchmark" applicant.)
- Compare each marginal control group approval to the benchmark applicant in each reason-for-denial ranking developed in step (b), above. If there are no approvals who are equally or less qualified, then there are no instances of disparate treatment for the institution to account for. For all such approvals that appear no better qualified than the denied benchmark applicant
    - identify the approved loan on the worksheet or spreadsheet as an "overlap approval," and
    - compare that overlap approval with other marginal prohibited basis denials in the ranking to determine whether additional overlaps exist. If so, identify all overlapping approvals and denials as above.
- Where the focal point involves use of a credit scoring system, the analysis for disparate treatment is similar to the procedures set forth in (c) above, and should focus primarily on overrides of the scoring system itself. For guidance on this type of analysis, refer to *Considering Automated Underwriting and Credit Scoring*, Part C in the **Appendix**.

Step 4. If there is some evidence of violations in the underwriting process but not enough to clearly establish the existence of a pattern or practice, the examiner should expand the sample as necessary to determine whether a pattern or practice does or does not exist.

Step 5. Discuss all findings resulting from the above comparisons with management and document both the findings and all conversations on an appropriate worksheet.

D. Analyzing Potential Disparities in Pricing and Other Terms and Conditions.

Depending on the intensity of the examination and the size of the borrower population to be reviewed, the analysis of decisions on pricing and other terms and conditions may involve a comparative file review, statistical analysis, a combination of the two, or other specialized technique used by an agency. Each examination process assesses an institution's credit-decision standards and whether decisions on pricing and other terms and conditions are applied to borrowers without regard to a prohibited basis.

The procedures below encompass the examination steps for a comparative file review. Examiners should consult their own agency's procedures for detailed guidance where appropriate. For example, when file reviews are undertaken in conjunction with statistical analysis, the guidance on specific sample sizes referenced below may not apply.

Step 1. Determine Sample Selection

Examiners may review data in its entirety or restrict their analysis to a sample depending on the examination approach used and the quality of the institution's compliance management system. The Fair Lending Sample Size Tables in the ***Appendix*** provide general guidance about appropriate sample sizes. Generally, the sample size should be based on the number of prohibited basis group and control group originations for each focal point selected during the 12 months preceding the examination and the outcome of the compliance management system analysis conducted in Part II. When possible, examiners should request specific loan files in advance and request that the institution have them available for review at the start of the examination.

Step 2. Determine Sample Composition and Create Applicant Profiles

Examiners should tailor their sample and subsequent analysis to the specific factors that the institution considers when determining its pricing, terms, and conditions. For example, while decisions on pricing, and other terms and conditions are part of an institution's underwriting process, general underwriting criteria should not be used in the analysis if they are not relevant to the term or condition to be reviewed. Additionally, consideration should be limited to factors which examiners determine to be legitimate.

While the period for review should be 12-months, prohibited basis group and control group borrowers should be grouped and reviewed around a range of dates during which the institution's practices for the term or condition being reviewed were the same. Generally, examiners should use the loan origination date or the loan application date.

Identify data to be analyzed for each focal point to be reviewed and record this information for each borrower on a spreadsheet to ensure a valid comparison regarding terms and conditions. For example, in certain cases, an institution may offer slightly differentiated products with significant pricing implications to borrowers. In these cases, it may be appropriate to group these procedures together for the purposes of evaluation.

Step 3. Review Terms and Conditions; Compare with Borrower Outcomes

a. Review all loan terms and conditions (rates, points, fees, maturity variations, LTVs, collateral requirements, etc.) with special attention to those which are left, in whole or in part, to the discretion of loan officers or underwriters. For each such term or condition, identify (a) any prohibited basis group borrowers in the sample who appear to have been treated unfavorably with respect to that term or condition and (b) any control group borrowers who appear to have been treated favorably with respect to that term or condition. The examiner's analysis should be thoroughly documented in the workpapers.

b. Identify from the sample universe any control group borrowers who appear to have been treated more favorably than one or more of the above-identified prohibited basis group borrowers and who have pricing or creditworthiness factors (under the institution's standards) that are equal to or less favorable than the prohibited basis group borrowers.

c. Obtain explanations from the appropriate loan officer or other employee for any differences that exist and reanalyze the sample for evidence of discrimination.

d. If there is some evidence of violations in the imposition of terms and conditions but not enough to clearly establish the existence of a pattern or practice, the examiner should expand the sample as necessary to determine whether a pattern or practice does or does not exist.

e. Discuss differences in comparable loans with the institution's management and document all conversations on an appropriate worksheet. For additional guidance on evaluating management's responses, refer to Part A, 1 – 5, *Evaluating Responses to Evidence of Disparate Treatment* in the **Appendix**.

E. Steering Analysis

An institution that offers a variety of lending products or product features, either through one channel or through multiple channels, may benefit consumers by offering greater choices and meeting the diverse needs of applicants. Greater product offerings and multiple channels, however, may also create a fair lending risk that applicants will be illegally steered to certain choices based on prohibited characteristics.

Several examples illustrate potential fair lending risk:

- An institution that offers different lending products based on credit risk levels may present opportunities for loan officers or brokers to illegally steer applicants to the higher-risk products.
- An institution that offers nontraditional loan products or loan products with potentially onerous terms (such as prepayment penalties) may present opportunities for loan officers or brokers to illegally steer applicants to certain products or features.
- An institution that offers prime or sub-prime products through different channels may present opportunities for applicants to be illegally steered to the sub-prime channel.

The distinction between guiding consumers toward a specific product or feature and illegal steering centers on whether the institution did so on a prohibited basis, rather than based on an applicant's needs or other legitimate factors. It is not necessary to demonstrate financial harm to a group that has been "steered." It is enough to demonstrate that action was taken on a prohibited basis regardless of the ultimate financial outcome. If the scoping analysis reveals the presence of one or more risk factors S1 through S8 for any selected focal point, consult with agency supervisory staff about conducting a steering analysis as described below.

Step 1. Clarify what options are available to applicants

Through interviews with appropriate personnel of the institution and review of policy manuals, procedure guidelines and other directives, obtain and verify the following information for each product-alternative product pairing or grouping identified above:

a. All underwriting criteria for the product or feature and their alternatives that are offered by the institution or by a subsidiary or affiliate. Examples of products may include stated income, negative amortization, and options ARMs. Examples of terms and features include prepayment penalties and escrow requirements. The distinction between a product, term, and feature may vary institution to institution. For example, some institutions may consider "stated income" a feature, whiles others may consider that a distinct product.

b. Pricing or other costs applicable to the product and the alternative product(s), including interest rates, points, and all fees.

Step 2. Document the policies, conditions, or criteria that have been adopted by the institution for determining how referrals are to be made and choices presented to applicants.

a. Obtain not only information regarding the product or feature offered by the institution and alternatives offered by subsidiaries/affiliates, but also information on alternatives offered solely by the institution itself.

b. Obtain any information regarding a subsidiary of the institution directly from that entity, but seek information regarding an affiliate or holding company subsidiary only from the institution itself.

c. Obtain all appropriate documentation and provide a written summary of all discussions with loan personnel and managers.

d. Obtain documentation and/or employee estimates as to the volume of referrals made from or to the institution, for each product, during a relevant time period.

e. Resolve to the extent possible any discrepancies between information found in the institution's documents and information obtained in discussions with loan personnel and managers by conducting appropriate follow-up interviews.

f. Identify any policies and procedures established by the institution and/or the subsidiary or affiliate for (i) referring a person who applies to the institution, but does not meet its criteria, to another internal lending channel, subsidiary or affiliate; (ii) offering one or more alternatives to a person who applies to the institution for a specific product or feature, but does not meet its criteria; or (iii) referring a person who applies to a subsidiary or affiliate for its product, but who appears qualified for a loan from the institution, to the institution; or referring a person who applies through one internal lending channel for a product, but who appears to be qualified for a loan through another lending channel to that particular lending channel.

g. Determine whether loan personnel are encouraged, through financial incentives or otherwise, to make referrals, either from the institution to a subsidiary/affiliate or vice versa. Similarly, determine whether the institution provides financial incentives related to products and features.

Step 3. Determine how referral decisions are made and documented within the institution.

Determine how a referral is made to another internal lending channel, subsidiary, or affiliate. Determine the reason for referral and how it is documented.

Step 4. Determine to what extent individual loan personnel are able to exercise personal discretion in deciding what loan products or other credit alternatives will be made available to a given applicant.

Step 5. Determine whether the institution's stated policies, conditions, or criteria in fact are adhered to by individual decision makers. If not, does it appear that different policies or practices are actually in effect?

Enter data from the prohibited basis group sample on the spread sheets and determine whether the institution is, in fact, applying its criteria as stated. For example, if one announced criterion for receiving a "more favorable" prime mortgage loan was a back end debt ratio of no more than 38%, review the spread sheets to determine whether that criteria was adhered to. If the institution's actual treatment of prohibited basis group applicants appears to differ from its stated criteria, document such differences for subsequent discussion with management.

Step 6. To the extent that individual loan personnel have any discretion in deciding what products and features to offer applicants, conduct a comparative analysis to determine whether that discretion has been exercised in a nondiscriminatory manner.

Compare the institution's or subsidiary/affiliate's treatment of control group and prohibited basis group applicants by adapting the "benchmark" and "overlap" technique discussed in Part III, Section C of these procedures. For purposes of this Steering Analysis, that technique should be conducted as follows:

a. For each focal point to be analyzed, select a sample of prohibited basis group applicants who received "less favorable" treatment (e.g., referral to a finance company or a subprime mortgage subsidiary or counteroffers of less favorable product alternatives).

   ***NOTE**: In selecting the sample, follow the guidance of Fair Lending Sample Size Tables, Table B in the **Appendix** and select "marginal applicants" as instructed in Part III, Section C, above.*

b. Prepare a spread sheet for the sample which contains data entry categories for those underwriting and/or referral criteria that the institution identified in Step 1.b as used in reaching underwriting and referral decisions between the pairs of products.

c. Review the "less favorably" treated prohibited basis group sample and rank this sample from least qualified to most qualified.

d. From the sample, identify the best qualified prohibited basis group applicant, based on the criteria identified for the control group, above. This applicant will be the "benchmark" applicant. Rank order the remaining applicants from best to least qualified.

e. Select a sample of control group applicants. Identify those who were treated "more favorably" with respect to the same product-alternative product pair as the

prohibited basis group. (Again refer to the Sample Size Table B and marginal applicant processes noted above in selecting the sample.)

f. Compare the qualifications of the benchmark applicant with those of the control group applicants, beginning with the least qualified member of that sample. Any control group applicant who appears less qualified than the benchmark applicant should be identified on the spreadsheet as a "control group overlap."

g. Compare all control group overlaps with other, less qualified prohibited basis group applicants to determine whether additional overlaps exist

h. Document all overlaps as possible disparities in treatment. Discuss all overlaps and related findings (e.g., any differences between stated and actual underwriting and/or referral criteria) with management, documenting all such conversations.

Step 7. Examiners should consult with their agency's supervisory staff if they see a need to contact control group or prohibited basis group applicants to substantiate the steering analysis.

F. Transactional Underwriting Analysis — Commercial Loans.

Overview: Unlike consumer credit, where loan products and prices are generally homogenous and underwriting involves the evaluation of a limited number of credit variables, commercial loans are generally unique and underwriting methods and loan pricing may vary depending on a large number of credit variables. The additional credit analysis that is involved in underwriting commercial credit products will entail additional complexity in the sampling and discrimination analysis process. Although ECOA prohibits discrimination in all commercial credit activities of a covered institution, the agencies recognize that small businesses (sole proprietorships, partnerships, and small, closely-held corporations) may have less experience in borrowing. Small businesses may have fewer borrowing options, which may make them more vulnerable to discrimination. Therefore, in implementing these procedures, examinations should generally be focused on small business credit (commercial applicants that had gross revenues of $1,000,000 or less in the preceding fiscal year), absent some evidence that a focus on other commercial products would be more appropriate.

Step 1. Understand Commercial Loan Policies

For the commercial product line selected for analysis, the examiner should first review credit policy guidelines and interview appropriate commercial loan managers and officers to obtain written and articulated standards used by the institution in evaluating commercial loan applications.

***NOTE**: Examiners should consult their own agencies for guidance on when a comparative analysis or statistical analysis is appropriate, and follow their agencies procedures for conducting such a review/analysis.*

Step 2. Conduct Comparative File Review

a. Select all (or a maximum of ten) denied applications that were acted on during the three month period prior to the examination. To the extent feasible, include denied applications from businesses that are (i) located in minority and/or integrated geographies or (ii) appear to be owned by women or minority group members, based on the names of the principals shown on applications or related documents. (In the case of institutions that do a significant volume of commercial lending, consider reviewing more than ten applications.)

b. For each of the denied commercial applications selected, record specific information from loan files and through interviews with the appropriate loan officer(s), about the principal owners, the purpose of the loan, and the specific, pertinent financial information about the commercial enterprise (including type of business — retail, manufacturing, service, etc.), that was used by the institution to evaluate the credit request. Maintenance or use of data that identifies prohibited basis characteristics of those involved with the business (either in approved or denied loan applications) should be evaluated as a potential violation of Regulation B.

c. Select ten approved loans that appear to be similar with regard to business type, purpose of loan, loan amount, loan terms, and type of collateral, as the denied loans sampled. For example, if the denied loan sample includes applications for lines of credit to cover inventory purchases for retail businesses, the examiner should select approved applications for lines of credit from retail businesses.

d. For each approved commercial loan application selected, obtain and record information parallel to that obtained for denied applications.

e. The examiner should first compare the credit criteria considered in the credit process for each of the approved and denied applications to established underwriting standards, rather than comparing files directly.

f. The examiner should identify any deviations from credit standards for both approved and denied credit requests, and differences in loan terms granted for approved credit requests.

g. The examiner should discuss each instance where deviations from credit standards and terms were noted, but were not explained in the file, with the commercial credit underwriter. Each discussion should be

documented.

Step 3. Conduct Targeted Sampling

a. If deviations from credit standards or pricing are not sufficiently explained by other factors either documented in the credit file or the commercial underwriter was not able to provide a reasonable explanation, the examiner should determine if deviations were detrimental to any protected classes of applicants.

b. The examiner should consider employing the same techniques for determining race and gender characteristics of commercial applicants as those outlined in the consumer loan sampling procedures.

c. If it is determined that there are members of one or more prohibited basis groups among commercial credit requests that were not underwritten according to established standards or received less favorable terms, the examiner should select additional commercial loans, where applicants are members of the same prohibited basis group and select similarly situated control group credit requests in order to determine whether there is a pattern or practice of discrimination. These additional files should be selected based on the specific applicant circumstance(s) that appeared to have been viewed differently by lending personnel on a prohibited basis.

d. If there are not enough similarly situated applicants for comparison in the original sample period to draw a reasonable conclusion, the examiner should expand the sample period. The expanded sample period should generally not go beyond the date of the prior examination.

Sampling Guidelines

a. Generally, the task of selecting an appropriate expanded sample of prohibited basis and control group applications for commercial loans will require examiner judgment. The examiner should select a sample that is large enough to be able to draw a reasonable conclusion.

b. The examiner should first select from the applications that were acted on during the initial sample period, but were not included in the initial sample, and select applications from prior time periods as necessary.

c. The expanded sample should include both approved and denied, prohibited basis and control group applications, where similar credit was requested by similar enterprises for similar purposes.

G. Analysis of Potential Discriminatory "Redlining"

Overview: For purposes of this analysis, traditional "redlining" is a form of illegal disparate treatment in which an 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.

The redlining analysis may be applied to determine whether, on a prohibited basis:

- an institution fails or refuses to extend credit in certain areas;
- an institution targets certain borrowers or certain areas with less advantageous products:
- an institution makes loans in such an area but at a restricted level or upon less-favorable terms or conditions as compared to contrasting areas; or
- an institution omits or excludes such an area from efforts to market residential loans or solicit customers for residential credit.

This guidance focuses on possible discrimination based on race or national origin. The same analysis could be adapted to evaluate relative access to credit for areas of geographical concentration on other prohibited bases — for example, age.

NOTE*: It is true that neither the Equal Credit Opportunity Act (ECOA) nor the Fair Housing Act (FHAct) specifically uses the term "redlining." However, federal courts as well as agencies that have enforcement responsibilities for the FHAct, have interpreted it as prohibiting institutions from having different marketing or lending practices for certain geographic areas, compared to others, where the purpose or effect of such differences would be to discriminate on a prohibited basis. Similarly, the ECOA would prohibit treating applicants for credit differently on the basis of differences in the racial or ethnic composition of their respective neighborhoods.*

Like other forms of disparate treatment, redlining can be proven by overt or comparative evidence. If any written or oral policy or statement of the institution (see risk factors R6-10 in Part I, above) suggests that the institution links the racial or national origin character of an area with any aspect of access to or terms of credit, the examiners should refer to the guidance in Section B of this Part III, on documenting and evaluating overt evidence of discrimination.

Overt evidence includes not only explicit statements, but also any geographical terms used by the institution that would, to a reasonable person familiar with the community in question, connote a specific racial or national origin character. For example, if the principal information conveyed by the phrase "north of 110th Street" is that the

indicated area is principally occupied by Hispanics, then a policy of not making credit available "north of 110th Street" is overt evidence of potential redlining on the basis of national origin.

Overt evidence is relatively uncommon. Consequently, the redlining analysis usually will focus on comparative evidence (similar to analyses of possible disparate treatment of individual customers) in which the institution's treatment of areas with contrasting racial or national origin characters is compared.

When the scoping process (including consultation within an agency as called for by agency procedures) indicates that a redlining analysis should be initiated, examiners should complete the following steps of comparative analysis:

1. Identify and delineate any areas within the institution's CRA assessment area and reasonably expected market area for residential products that have a racial or national origin character;
2. Determine whether any minority area identified in Step 1 appears to be excluded, under-served, selectively excluded from marketing efforts, or otherwise less-favorably treated in any way by the institution;
3. Identify and delineate any areas within the institution's CRA assessment area and reasonably expected market area for residential products that are non-minority in character and that the institution appears to treat more favorably;
4. Identify the location of any minority areas located just outside the institution's CRA assessment area and market area for residential products, such that the institution may be purposely avoiding such areas;
5. Obtain the institution's explanation for the apparent difference in treatment between the areas and evaluate whether it is credible and reasonable; and
6. Obtain and evaluate other information that may support or contradict interpreting identified disparities to be the result of intentional illegal discrimination.

These steps are discussed in detail below.

Using Information Obtained During Scoping

Although the six tasks listed are presented below as examination steps in the order given above, examiners should recognize that a different order may be preferable in any given examination. For example, the institution's explanation (Step 5) for one of the policies or patterns in question may already be documented in the CRA materials reviewed (Step 1) and the CRA examiners may already have verified it, which may be sufficient for purposes of the redlining analysis.

As another example, as part of the scoping process, the examiners may have reviewed an analysis of the geographic distribution of the institution's loan originations with respect to the racial and national origin composition of census tracts within its CRA assessment or residential market area. Such analysis might have documented the existence of significant discrepancies between areas, by degree of minority concentration, in loans originated (risk factor R1), approval/denial rates (risk factor R2), and/or rates of denials because of insufficient collateral (risk factor R3). In such a situation in which the scoping process has produced a reliable factual record, the examiners could begin with Step 5 (obtaining an explanation) of the redlining analysis below.

In contrast, when the scoping process only yields partial or questionable information, or when the risk factors on which the redlining analysis is based on complaints or allegations against the institution, Steps 1-4 must be addressed.

Comparative analysis for redlining

Step 1. Identify and delineate any areas within the institution's CRA assessment area and reasonably expected market area for residential products that are of a racial or national origin minority character.

NOTE*: The CRA assessment area can be a convenient unit for redlining analysis because information about it typically already is in hand. However, the CRA assessment area may be too limited. The redlining analysis focuses on the institution's decisions about how much access to credit to provide to different geographical areas. The areas for which those decisions can best be compared are areas where the institution actually marketed and provided credit and where it could reasonably be expected to have marketed and provided credit. Some of those areas might be beyond or otherwise different from the CRA assessment area.*

If there are no areas identifiable for their racial or national origin minority character within the institution's CRA assessment area or reasonably expected market area for residential products, a redlining analysis is not appropriate. (If there is a substantial but dispersed minority population, potential disparate treatment can be evaluated by a routine comparative file review of applicants.)

This step may have been substantially completed during scoping, but unresolved matters may remain. (For example, several community spokespersons may allege that the institution is redlining, but disagree in defining the area). The examiners should:

a. Describe as precisely as possible why a specific area is recognized in the community (perceptions of residents, etc.) and/or is objectively identifiable (based on census or other data) as having a particular racial or national origin minority character.

- The most obvious identifier is the predominant race or national origin of the residents of the area. Examiners should document the percentages of racial or national origin minorities residing within the census tracts that make up the area. Analyzing racial and national origin concentrations in quartiles (such as 0 to <=25%, >25% to < = 50%, >50% to <= 75%, and >75%) or based on majority concentration (0 to <=50%, and >50%) may be helpful. However, examiners should bear in mind that it is illegal for the institution to consider a prohibited factor in any way. For example, an area or neighborhood may only have a minority population of 20%, but if the area's concentration appears related to lending practices, it would be appropriate to use that area's level of concentration in the analysis. Contacts with community groups can be helpful to learn whether there are such subtle features of racial or ethnic character within a particular neighborhood.
- Geographical groupings that are convenient for CRA may obscure racial patterns. For example, an underserved, low-income, predominantly minority neighborhood that lies within a larger low-income area that primarily consisted of non-minority neighborhoods may seem adequately served when the entire low-income area is analyzed as a unit. However, a racial pattern of underservice to minority areas might be revealed if the low-income minority neighborhood shared a border with an underserved, middle-income, minority area and those two minority areas were grouped together for purposes of analysis.

b. Describe how the racial or national origin character changes across the suspected redlining area's various boundaries.

c. Document or estimate the demand for credit, within the minority area. This may include the applicable demographics of the area, including the percentage of homeowners, the median house value, median family income, or the number of small businesses, etc. Review the institution's non-originated loan applications from the suspected redlined areas. If available, review aggregate institution data for loans originated and applications received from the suspected redlined areas. Community contacts may also be helpful in determining the demand for such credit. If the minority area does not have a significant amount of demand for such credit, the area is not appropriate for a redlining analysis.

Step 2. Determine whether any minority area identified in Step 1 is excluded, under-served, selectively excluded from marketing efforts, or otherwise less-favorably treated in any way by the institution.

The examiners should begin with the risk factors identified during the scoping process. The unfavorable treatment may have been substantially documented during scoping and needs only to be finished in this step. If not, this step will verify and measure the extent to which HMDA data show the minority areas identified in Step 1 to be underserved and/or how the institution's explicit policies treat them less favorably.

a. Review prior CRA lending test analyses to learn whether they have identified any excluded or otherwise under-served areas or other significant geographical disparities in the institution's lending. Determine whether any of those are the minority areas identified in Step 1.

b. Learn from the institution itself whether, as a matter of policy, it treats any separate or distinct geographical areas within its marketing or service area differently from other areas. This may have been done completely or partially during scoping analysis related to risk factors R5-R9. The differences in treatment can be in marketing, products offered, branch operations (including the services provided and the hours of operation), appraisal practices, application processing, approval requirements, pricing, loan conditions, evaluation of collateral, or any other policy or practice materially related to access to credit. Determine whether any of those less-favored areas are the minority areas identified in Step 1.

c. Obtain from the institution: (i) its reasons for such differences in policy, (ii) how the differences are implemented, and (iii) any specific conditions that must exist in an area for it to receive the particular treatment (more favorable or less favorable) that the institution has indicated.

Step 3. Identify and delineate any areas within the institution's CRA assessment area and reasonably expected market area for residential products that are non-minority in character and that the institution appears to treat more favorably.

To the extent not already completed during scoping:

a. Document the percentages of control group and of racial or national origin minorities residing within the census tract(s) that comprise(s) the non-minority area.

b. Document the nature of the housing stock in the area.

c. Describe, to the extent known, how the institution's practices, policies, or its rate of lending change from less-to more-favorable as one leaves the minority area at its various boundaries. (Examiners

should be particularly attentive to instances in which the boundaries between favored and disfavored areas deviate from boundaries the institution would reasonably be expected to follow, such as political boundaries or transportation barriers.)

d. Examiners should particularly consider whether, within a large area that is composed predominantly of racial or national origin minority households, there are enclaves that are predominantly non-minority or whether, along the area's borders, there are irregularities where the non- minority group is predominant. As part of the overall comparison, examiners should determine whether credit access within those small non-minority areas differs from credit access in the larger minority area.

Step 4. Identify the location of any minority areas located just outside the institution's CRA assessment area and market area for residential products, such that the institution may be purposely avoiding such areas.

Review the analysis from prior CRA examinations of whether the assessment area appears to have been influenced by prohibited factors. If there are minority areas that the institution excluded from the assessment area improperly, consider whether they ought to be included in the redlining analysis. Analyze the institution's reasonably expected market area in the same manner.

Step 5. Obtain the institution's explanation for the apparent difference in treatment between the areas and evaluate whether it is credible and reasonable.

This step completes the comparative analysis by soliciting from the institution any additional information not yet considered by the examiners that might show that there is a nondiscriminatory explanation for the apparent disparate treatment based on race or ethnicity.

For each matter that requires explanation, provide the institution full information about what differences appear to exist in how it treats minority and non-minority areas, and how the examiners reached their preliminary conclusions at this stage of the analysis.

a. Evaluate whether the conditions identified by the institution in Step 2 as justifying more favorable treatment pursuant to institutional policy existed in minority neighborhoods that did not receive the favorable treatment called for by institutional policy. If there are minority areas for which those conditions existed, ask the institution to explain why the areas were treated differently despite the similar conditions.

b. Evaluate whether the conditions identified by the institution in Step 2 as justifying less favorable treatment pursuant to institutional policy existed in non-minority neighborhoods that received favorable treatment nevertheless. If there are non-minority areas for which those conditions existed, ask the institution to explain why those areas were treated differently, despite the similar conditions.

c. Obtain explanations from the institution for any apparent differences in treatment observed by the examiners but not called for by the institution's policies:

- If the institution's explanation cites any specific conditions in the non-minority area(s) to justify more favorable treatment, determine whether the minority area(s) identified in Step 1 satisfied those conditions. If there are minority areas for which those conditions existed, ask the institution to explain why the areas were treated differently despite the similar conditions.
- If the institution's explanation cites any specific conditions in the minority area(s) to justify less favorable treatment, determine whether the non-minority area(s) had those conditions. If there are non-minority areas for which those conditions existed, ask the institution to explain why those areas were treated differently, despite the similar conditions.

d. Evaluate the institution's responses by applying appropriate principles selected from the **Appendix** on Evaluating Responses to Evidence of Disparate Treatment.

Step 6. Obtain and evaluate specific types of other information that may support or contradict a finding of redlining.

As a legal matter, discriminatory intent can be inferred simply from the lack of a legitimate explanation for clearly less- favorable treatment of racial or national origin minorities. Nevertheless, if the institution's explanations do not adequately account for a documented difference in treatment, the examiners should consider additional information that might support or contradict the interpretation that the difference in treatment constituted redlining.

a. *Comparative file review.* If there was a comparative file review conducted in conjunction with the redlining examination, review the results; or, if it is necessary and feasible to do so to clarify what appears to be discriminatory redlining, compare denied applications from within the suspected redlining area to approved applications from the contrasting area.

- Learn whether there were any denials of fully qualified applicants from the suspected redlining area. If so, that may

support the view that the institution was avoiding doing business in the area.

- Learn whether the file review identified instances of illegal disparate treatment against applicants of the same race or national origin as the suspected redlining area. If so, that may support the view that the institution was avoiding doing business with applicants of that group, such as the residents of the suspected redlining area. Learn whether any such identified victims applied for transactions in the suspected redlining area.
- If there are instances of either of the above, identify denied non-minority residents, if any, of the suspected redlining area and review their application files to learn whether they appear to have been treated in an irregular or less favorable way. If so, that may support the view that the character of the area rather than of the applicants themselves appears to have influenced the credit decisions.
- Review withdrawn and incomplete applications for the suspected redlining area, if those can readily be identified from the HMDA-LAR, and learn whether there are reliable indications that the institution discouraged those applicants from applying. If so, that may support the view that the institution was avoiding conducting business in the area and may constitute evidence of a violation of Section 1002.4(b) of Regulation B. Conversely, if the comparisons of individual transactions show that the institution treated minority and non-minority applicants within and outside the suspected redlining area similarly, that tends to contradict the conclusion that the institution avoided the areas because it had minority residents.

b. *Interviews of third parties.* The perspectives of third parties will have been taken into account to some degree through the review of available materials during scoping. Later in the examination, in appropriate circumstances, information from third parties may help determine whether the institution's apparent differences in treatment of minority and non-minority areas constitute redlining.

- Identify persons (such as housing or credit counselors, home improvement contractors, or real estate and mortgage brokers) who may have extensive experience dealing with credit applicants from the suspected redlined area.
- After obtaining appropriate authorization and guidance from your agency, interview those persons to learn of their first-hand experiences related to:
  - oral statements or written indications by an institution's representatives that loan applications from a suspected redlined area were discouraged;
  - whether the institution treated applicants from the suspected redlining area as called for in its own procedures (as the examiners understand them) and/or whether it treated them similarly to applicants from non-minority areas (as the examiners are familiar with those transactions);
  - any unusual delays or irregularities in loan processing for transactions in the suspected redlining area; and
  - differences in the institution's pricing, loan conditions, property valuation practices, etc., in the suspected redlining area compared to contrasting areas.

Also, learn from the third parties the names of any consumers they described as having experienced the questionable behavior recounted by the third party, and consider contacting those consumers.

If third parties witnessed specific conduct by the institution that indicates the institution wanted to avoid business from the area or prohibited basis group in question, this would tend to support interpreting the difference in treatment as intended. Conversely, if third parties report proper treatment or positive actions toward such area or prohibited basis group, this would tend to contradict the view that the institution intended to discriminate.

c. *Marketing*. A clear exclusion of the suspected redlining area from the institution's marketing of residential loan products supports the view that the institution did not want to do business in the area. Marketing decisions are affirmative acts to include or exclude areas. Disparities in marketing between two areas may reveal that the institution prefers one to the other. If sufficiently stark and supported by other evidence, a difference in marketing to racially different areas could itself be treated as a redlining violation of the Fair Housing Act. Even below that level of difference, marketing patterns can support or contradict the view that disparities in lending practices were intentional.

- Review materials that show how the institution has marketed in the suspected redlined area and in non-minority areas. Begin with available CRA materials and discuss the issues with CRA examiners, then review other materials as appropriate. The materials may include, for example, the institution's guidance for the geographical distribution of pre-approved solicitations for credit cards or home equity lines of credit, advertisements in local media or business or telephone directories, business development calls to real estate brokers, and calls by telemarketers.

e. *Peer performance*. Market share analysis and other comparisons to competitors are insufficient by themselves to prove that an institution engaged in illegal redlining. By the same token, an institution cannot justify its own failure to market or lend in an area by citing other institutions' failures to lend or market there.

However, an institution's inactivity in an underserved area where its acknowledged competitors are active would tend to support the interpretation that it intends to avoid doing business in the area. Conversely, if it is as active as other institutions that would suggest that it intends to compete for, rather than avoid, business in the area.

- Develop a list of the institution's competitors.
- Learn the level of lending in the suspected redlining area by competitors. Check any public evaluations of similarly situated competitors obtained by the CRA examiners as part of evaluating the performance context or obtain such evaluations independently.

f. Institution's record. Request from the institution information about its overall record of serving or attempting to serve the racial or national origin minority group with which the suspected redlining area is identified. The record may reveal intent to serve that group that tends to contradict the view that the institution intends to discriminate against the group.

***NOTE**: For any information that supports interpreting the situation as illegal discrimination, obtain and evaluate an explanation from the institution as called for in Part IV. If the institution's explanation is that the disparate results are the consequence of a specific, neutral policy or practice that the institution applies broadly, such as not making loans on homes below a certain value, review the guidance in the Special Analyses section of the **Appendix** under Disproportionate Adverse Impact Violations and consult agency managers.*

H. Analysis of Potential Discriminatory Marketing Practices.

When scoping identifies significant risk factors (M1-M7) related to marketing, examiners should consult their agency's supervisory staff and experts about a possible marketing discrimination analysis. If the supervisory staff agrees to proceed, the examiners should collect information as follows:

Step 1. Identify the institution's marketing initiatives.

a. *Pre-approved solicitations*

- Determine whether the institution sends out pre-approved solicitations:
  - For home purchase loans,
  - For home improvement loans, or
  - For refinance loans.
- Determine how the institution selects recipients for such solicitations
  - Learn from the institution its criteria for such selections.
  - Review any guidance or other information the institution provided credit reporting companies or other companies that supply such lists.

b. *Media Usage*

- Determine in which newspapers and broadcast media the institution advertises.
  - Identify any racial or national origin identity associated with those media.
  - Determine whether those media focus on geographical communities of a particular racial or national origin character.
- Learn the institution's strategies for geographic and demographic distribution of advertisements.
- Obtain and review copies of the institution's printed advertising and promotional materials.
- Determine what criteria the institution communicates to media about what is an attractive customer or an attractive area to cultivate business.
- Determine whether advertising and marketing are the same to racial and national origin minority areas as compared to non-minority areas.

c. *Self-produced promotional materials*

- Learn how the institution distributes its own promotional materials, both methods and geographical distribution.
- Learn what the institution regards as the target audience(s) for those materials.

d. *Realtors, brokers, contractors, and other intermediaries*

- Determine whether the institution solicits business from specific realtors, brokers, home improvement contractors, and other conduits.
  - Learn how the institution decides which intermediaries it will solicit.
  - Identify the parties contacted and determine the distribution between minority and non-minority areas.

- Obtain and review the types of information the institution distributes to intermediaries.
- Determine how often the institution contacts intermediaries.
- Determine what criteria the institution communicates to intermediaries about the type of customers it seeks or the nature of the geographic areas in which it wishes to do business.

e. *Telemarketers or predictive dialer programs*

- Learn how the institution identifies which consumers to contact, and whether the institution sets any parameters on how the list of consumers is compiled.

Step 2. Determine whether the institution's activities show a significantly lower level of marketing effort toward minority areas or toward media or intermediaries that tend to reach minority areas.

Step 3. If there is any such disparity, document the institution's explanation for it.

For additional guidance, refer to Part C of the *Special Analyses* section in the **Appendix**.

I. Credit Scoring.

If the scoping process results in the selection of a focal point that includes a credit or mortgage scored loan product, refer to the *Considering Automated Underwriting and Credit Scoring* section of the **Appendix**.

If the institution utilizes a credit scoring program which scores age for any loan product selected for review in the scoping stage, either as the sole underwriting determinant or only as a guide to making loan decisions, refer to Part E of the *Considering Automated Underwriting and Credit Scoring* section of the **Appendix**.

~~**J. Disparate Impact Issues.**~~

~~These procedures have thus far focused primarily on examining comparative evidence for possible unlawful disparate treatment. Disparate impact has been described briefly in the Introduction. Whenever an examiner believes that a particular policy or practice of an institution appears to have a disparate impact on a prohibited basis, the examiner should refer to Part A of the *Special Analyses* section of the ***Appendix*** or consult with agency supervisory staff for further guidance.~~

Part IV — Obtaining and Evaluating Responses From the Institution and Concluding the Examination

Step 1. Present to the institution's management for explanation:

a. Any overt evidence of disparate treatment on a prohibited basis.

b. All instances of apparent disparate treatment (e.g., overlaps) in either the underwriting of loans or in loan prices, terms, or conditions.

c. All instances of apparent disparate treatment in the form of discriminatory steering, redlining, or marketing policies or practices.

d. All instances where a denied prohibited basis applicant was not afforded the same level of assistance or the same benefit of discretion as an approved control group applicant who was no better qualified with regard to the reason for denial.

e. All instances where a prohibited basis applicant received conspicuously less favorable treatment by the institution than was customary from the institution or was required by the institution's policy.

f. Any statistically significant average difference in either the frequency or amount of pricing disparities between control group and prohibited basis group applicants.

~~g. Any evidence of neutral policies, procedures or practices that appear to have a disparate impact or effect on a prohibited basis.~~

Explain that unless there are legitimate, nondiscriminatory explanations ~~(or in the case of disparate impact, a compelling business justification)~~ for each of the preliminary findings of discrimination identified in this Part, the agency could conclude that the institution is in violation of the applicable fair lending laws.

Step 2. Document all responses that have been provided by the institution, not just its "best" or "final" response. Document each discussion with dates, names, titles, questions, responses, any information that supports or undercuts the institution's credibility, and any other information that bears on the issues raised in the discussion(s).

Step 3. Evaluate whether the responses are consistent with previous statements, information obtained from file review, documents, reasonable banking practices, and other sources, and satisfy common-sense standards of logic and credibility.

~~a. Do not speculate or assume that the institution's decision- maker had specific intentions or considerations in mind when he or she took the actions being evaluated. Do not, for example, conclude that because you have noticed a legitimate, nondiscriminatory reason for a denial (such as an~~

~~applicant's credit weakness), that no discrimination occurred unless it is clear that, at the time of the denial, the institution actually based the denial on that reason.~~

b. Perform follow-up file reviews and comparative analyses, as necessary, to determine the accuracy and credibility of the institution's explanations.

c. Refer to *Evaluating Responses to Evidence of Disparate Treatment* in the **Appendix** for guidance as to common types of responses.

~~d. Refer to the Disproportionate Adverse Impact Violations portion of the Special Analyses section of the **Appendix** for guidance on evaluating the institution's responses to apparent disparate impact.~~

Step 4. If, after completing Steps 1–3 above, you conclude that the institution has failed to adequately demonstrate that one or more apparent violations had a legitimate nondiscriminatory basis or were otherwise lawful, prepare a documented list or discussion of violations, or a draft examination report, as prescribed by agency directives.

Step 5. Consult with agency supervisory staff regarding whether (a) any violations should be referred to the Departments of Justice or Housing and Urban Development and (b) enforcement action should be undertaken by your agency.

References

FIL-29-2023 *Interagency Guidance on Third-Party Relationships: Risk Management;*

FIL-3-2021: *FDIC Adopts Rule on the Role of Supervisory Guidance;*

FDIC Final Rule: *Role of Supervisory Guidance*

FIL-5-2015: *Statement on Providing Banking Services; and*

Part 364: *Standards for Safety and Soundness*

Appendix

Introduction

This Appendix offers a full range of information that might conceivably be brought to bear in an examination. In that sense, it is a "menu" of resources to be considered and selected from, depending on the nature and scope of the examination being conducted.

Compliance Management Analysis Checklist

This checklist is for use in conjunction with Part II of these procedures as a device for examiners to evaluate the strength of an institution's compliance program in terms of its capacity to prevent, and to identify and self-correct fair lending violations in connection with the products or issues selected for analysis. The checklist is not intended to be an absolute test of an institution's compliance management program. Programs containing all or most of the features described in the list may nonetheless be flawed for other reasons; conversely, a compliance program that encompasses only a portion of the factors listed below may nonetheless adequately support a strong program under appropriate circumstances. In short, the examiner must exercise his or her best judgment in utilizing this list and in assessing the overall quality of an institution's efforts to ensure fair lending compliance.

If the transactions within the proposed scope are covered by a listed preventive measure, and the answer is "Yes", check the box in the first column. You may then reduce the intensity (mainly the sample size) of the planned comparative file review to the degree that the preventive measures cover transactions within the proposed scope. Document your findings in sufficient detail to justify any resulting reduction in the intensity of the examination.

You are not required to learn whether preventive measures apply to specific products outside the proposed scope. However, if the information you have obtained shows that the measure is a general practice of the institution, and thus applies to all loan products, check the box in the second column in order to assist future examination planning.

Preventive Measures

Determine whether policies and procedures exist that tend to prevent illegal disparate treatment in the transactions you plan to examine. There is no legal or agency requirement for institutions to conduct these activities. The absence of any of these policies and practices is never, by itself, a violation.

1. Lending Practices and Standards

	Within the proposed scope	Lender-wide
b. Do training, application-processing aids, and other guidance correctly and adequately describe:		
1. Prohibited bases under ECOA, Regulation B, and the Fair Housing Act?		
2. Other substantive credit access requirements of Regulation B (e.g. spousal signatures, improper inquiries, protected income)?		
c. Is it specifically communicated to employees that they must not, on a prohibited basis:		
1. Refuse to deal with individuals inquiring about credit?		
2. Discourage inquiries or applicants by delays, discourtesy, or other means?		
3. Provide different, incomplete, or misleading information about the availability of loans, application requirements, and processing and approval standards or procedures (including selectively informing applicants about certain loan products while failing to inform them of alternatives)?		
4. Encourage or more vigorously assist only certain inquirers or applicants?		
5. Refer credit seekers to other institutions, more costly loan products, or potentially onerous features?		

	Within the proposed scope	Lender-wide
6. Refer credit seekers to nontraditional products (i.e., negative amortization, "interest only," "payment option," "adjustable rate mortgages") when they could have qualified for traditional mortgages?		
7. Waive or grant exceptions to application procedures or credit standards?		
8. State a willingness to negotiate?		
9. Use different procedures or standards to evaluate applications?		
10. Use different procedures to obtain and evaluate appraisals?		
11. Provide certain applicants opportunities to correct or explain adverse or inadequate information, or to provide additional information?		
12. Accept alternative proofs of creditworthiness?		
13. Require cosigners?		
14. Offer or authorize loan modifications?		
15. Suggest or permit loan assumptions?		
16. Impose late charges, reinstatement fees, etc.?		
17. Initiate collection or foreclosure?		

	Within the proposed scope	Lender-wide
d. Has the institution taken specific initiatives to prevent the following practices:		
1. Basing credit decisions on assumptions derived from racial, gender, and other stereotypes, rather than facts?		
2. Seeking customers from a particular racial, ethnic, or religious group, or of a particular gender, to the exclusion of other types of customers, on the basis of how "comfortable" the employee may feel in dealing with those different from him/her?		
3. Limiting the exchange of credit-related information for the institution's efforts to qualify an applicant from a prohibited basis group.		
4. Drawing the institution's CRA assessment area by unreasonably excluding minority areas?		
5. Targeting certain borrowers or areas with less advantageous products?		
e. Does the institution have procedures to ensure that it does not:		
1. State racial or ethnic limitations in advertisements?		
2. Employ code words or use photos in advertisements that convey racial or ethnic limitations or preferences?		
3. Place advertisements that a reasonable person would regard as indicating minority consumers are less desirable?		
4. Advertise only in media serving predominantly minority or non-minority areas of the market?		
5. Conduct other forms of marketing differentially in minority or non-minority areas of the market?		
6. Market only through brokers known to serve only one racial or ethnic group in the market?		
7. Use a prohibited basis in any pre-screened solicitation?		
8. Provide financial incentives for loan officers to place applicants in nontraditional products or higher-risk products?		

2. Compliance Audit Function: Does the Institution Attempt to Detect Prohibited Disparate Treatment by Self-Test or Self-Evaluation?

NOTE: *A self-test is any program, practice or study that is designed and specifically used to assess the institution's compliance with the ECOA and the Fair Housing Act. It creates data or factual information that is not otherwise available and cannot be derived from loan, application or other records related to credit transactions (12 CFR 1002.15(b)(1) and (24 CFR 100.141). The report, results, and many other records associated with a self-test are privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. See 12 CFR 1002.15(b)(2) and 24 CFR 100.142(a) for a complete listing of the types of information covered by the privilege. A self-evaluation, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other records used in credit transactions and, therefore, does not meet the self-test definition. See Using Self-Tests and Self-Evaluations to Streamline the Examination in this* ***Appendix*** *for more information about self-tests and self-evaluations.*

While you may request the results of self-evaluations, you should not request the results of self-tests or any of the information listed in 12 CFR 1002.15(b)(2) and 24 CFR 100.142(a). If an institution discloses the self-test report or results to its regulator, it will lose the privilege. The following items are intended to obtain information about the institution's approach to self-testing and self-evaluation, not the findings. Complete the checklist below for each self-evaluation and each self-test, where the institution voluntarily discloses the report or results. Evaluating the results of self-evaluations and voluntarily disclosed self-tests is described in Using Self-Tests and Self-Evaluations to Streamline the Examination in the **Appendix**.

Mark the box if the answer is "yes" for the transactions within the scope.

	Within the proposed scope	Lender-wide
a. Are the transactions reviewed by an independent analyst who:		
1. Is directed to report objective results?		
2. Has an adequate level of expertise?		
3. Produces written conclusions?		
b. Does the institution's approach for self-testing or self-evaluation call for:		
1. Attempting to explain major patterns shown in the HMDA or other loan data?		
2. Determining whether actual practices and standards differ from stated ones and basing the evaluation on the actual practices?		
3. Evaluating whether the reasons cited for denial are supported by facts relied on by the decision maker at the time of the decision?		
4. Comparing the treatment of prohibited basis group applicants to control group applicants?		
5. Obtaining explanations from decision makers for any unfavorable treatment of the prohibited basis group that departed from policy or customary practice?		

	Within the proposed scope	Lender-wide
6. Covering significant decision points in the loan process where disparate treatment or discouragement might occur, including:		
The approve/deny decision?		
Pricing?		
Other terms and conditions?		
7. Covering at least as many transactions as examiners would independently, if using the Fair Lending Sample Size Tables for a product with the application volumes of the product to be evaluated?		
8. Maintaining information concerning personal characteristics collected as part of a self-test separately from application or loan files?		
9. Timely analysis of the data?		
10. Taking appropriate and timely corrective action?		
c. In the institution's plan for comparing the treatment of prohibited basis group applicants with that of control group applicants:		
1. Are control and prohibited basis groups based on a prohibited basis found in ECOA or the FHAct and defined clearly to isolate that prohibited basis for analysis?		
2. Are appropriate data to be obtained to document treatment of applicants and the relative qualifications vis-à-vis the requirement in question?		
3. Will the data to be obtained reflect the data on which decisions were based?		
4. Does the plan call for comparing the denied applicants' qualifications related to the stated reason for denial with the corresponding qualifications for approved applicants?		
5. Are comparisons designed to identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?		
6. Is the evaluation designed to determine whether control and prohibited basis group applicants were treated differently in the processes by which the institution helped applicants overcome obstacles and by which their qualifications were enhanced?		
7. Are responses and explanations to be obtained for any apparent disparate treatment on a prohibited basis or other apparent violations of credit rights?		
8. Are reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment to be verified?		

	Within the proposed scope	Lender-wide
d. For self-tests under ECOA that involved the collection of applicant personal characteristics, did the institution:		
1. Develop a written plan that describes or identifies the:		
Specific purpose of the self-test?		
Methodology to be used?		
Geographic area(s) to be covered?		
Type(s) of credit transactions to be reviewed?		
Entity that will conduct the test and analyze the data?		
Timing of the test, including start and end dates or the duration of the self-test?		
Other related self-test data that is not privileged?		
2. Disclose at the time applicant characteristic information is requested, that:		
The applicant will not be required to provide the information?		
The creditor is requesting the information to monitor its compliance with ECOA?		
Federal law prohibits the creditor from discriminating on the basis of this information or on the basis of an applicant's decision not to furnish the information?		
If applicable, certain information will be collected based on visual observation or surname if not provided by the applicant?		

3. Corrective Measures

	Within the proposed scope	Lender-wide
a. Determine whether the institution has provisions to take appropriate corrective action and provide adequate relief to victims for any violations in the transactions you plan to review.		
1. Who is to receive the results of a self-evaluation or voluntarily disclosed self-test?		
2. What decision process is supposed to follow delivery of the information?		
3. Is feedback to be given to staff whose actions are reviewed?		
4.. What types of corrective action may occur?		
5. Are customers to be:		
Offered credit if they were improperly denied?		
Compensated for any damages, both out of pocket and compensatory?		
Notified of their legal rights?		
b. Other corrective action:		
1. Are institutional policies or procedures that may have contributed to the discrimination to be corrected?		
2. Are employees involved to be trained and/or disciplined?		
3. Is the need for community outreach programs and/or changes in marketing strategy or loan products to better serve minority segments of the institution's market to be considered?		
4. Are audit and oversight systems to be improved in order to ensure there is not recurrence of any identified discrimination?		

Considering Automated Underwriting and Credit Scoring

These procedures are designed to help an examiner draw and support fair lending conclusions in situations involving automated underwriting or credit scoring.

A. Structure and Organization of the Scoring System

Determine the utilization of credit scoring at the institution including

1. For each customized credit scoring model or scorecard for any product, or for any credit scoring model used in connection with a product held in portfolio, identify and obtain:
   a. The number and inter-relationship of each model or scorecard applied to a particular product;
   b. The purposes for which each scorecard is employed (e.g., approval decision, set credit limits, set pricing, determine processing requirements, etc.);
   c. The developer of each scorecard used (e.g., in-house department, affiliate, independent vendor name) and describe the development population utilized;
   d. The types of monitoring reports generated (including front-end, back-end, and account management ~~and any disparate impact analyses~~), the frequency of generation and recent copies of each;
   e. All policies applicable to the use of credit scoring;
   f. Training materials and programs on credit scoring for employees, agents and brokers involved in any aspect of retail lending;
   g. Any action taken to revalidate or re-calibrate any model or scorecard used during the exam period and the reason(s) why;
   h. The number of all high-side and low-side overrides for each type of override occurring during the exam period and any guidance given to employees on their ability to override;
   i. All cutoffs used for each scorecard throughout the examination period and the reasons for the cutoffs and any change made during the exam period;
   j. All variables scored by each product's scorecard(s) and the values that each variable may take; and
   k. The method used to select for disclosure those adverse action reasons arising from application of the model or scorecard.
2. For each judgmental underwriting system that includes as an underwriting criterion a standard credit bureau or secondary market credit score, identify:
   a. The vendor of each credit score and any vendor recommendation or guidance on the usage of the score relied upon by the institution;
   b. The institution's basis for using the particular bureau or secondary market score and the cutoff standards for each product's underwriting system and the reasons for the cutoffs and any changes to the same during the exam period;
   c. The number of exceptions or overrides made to the credit score component of the underwriting criteria and the basis for those exceptions or overrides, including any guidance given to employees on their ability to depart from credit score underwriting standards; and
   d. Types of monitoring reports generated on the judgmental system or its credit scoring component (including front-end, back-end, differential processing ~~and disparate impact analysis~~), the frequency of generation and recent copies of each.

B. Adverse Action Disclosure Notices

Determine the methodology used to select the reasons why adverse action was taken on a credit application denied on the basis of the applicant's credit score. Compare the methodology used to the examples recited in the Commentary to Regulation B and decide acceptability against that standard. Identify any consumer requests for reconsideration of credit score denial reasons and review the action taken by management for consistency across applicant groups.

Where a credit score is used to differentiate application processing, and an applicant is denied for failure to attain a judgmental underwriting standard that would not be applied if the applicant had received a better credit score (thereby being considered in a different—presumably less stringent—application processing group), ensure that the adverse action notice also discloses the bases on which the applicant failed to attain the credit score required for consideration in the less stringent processing group.

C. Disparate Treatment in the Application of Credit Scoring Programs

1. Determine what controls and policies management has implemented to ensure that the institution's credit scoring models or credit score criteria are not applied in a discriminatory manner, in particular:
   a. Examine institution guidance on using the credit scoring system, on handling overrides and on processing applicants and how well that guidance is understood and observed by the targeted employees and monitored for compliance by management; and
   b. Examine institution policies that permit overrides or that provide for different processing or underwriting requirements based on geographic identifiers or borrower score ranges to assure that they do not treat protected group applicants differently than other similarly situated applicants.
2. Evaluate whether any of the bases for granting credit to control group applicants who are low-side overrides are applicable to any prohibited basis denials whose credit

score was equal to or greater than the lowest score among the low-side overrides. If such cases are identified, obtain and evaluate management's reason for why such different treatment is not a fair lending violation.

3. Evaluate whether any of the bases for denying credit to any prohibited basis applicants who are high-side overrides are applicable to any control group approvals whose credit score was equal to or less than the highest score among the prohibited basis high-side overrides. If such cases are identified, obtain and evaluate management's reason for why such different treatment is not a fair lending violation.
4. If credit scores are used to segment applicants into groups that receive different processing or are required to meet additional underwriting requirements (e.g., "tiered risk underwriting"), perform a comparative file review, or confirm the results and adequacy of management's comparative file review, that evaluates whether all applicants within each group are treated equally.

~~**D. Disparate Impact and Credit Scoring Algorithms**~~

~~Consult with agency supervisory staff to assess potential disparate treatment issues relating to the credit scoring algorithm.~~

E. Credit Scoring Systems that Include Age

Regulation B expressly requires the initial validation and periodic revalidation of a credit scoring system that considers age. There are two ways a credit scoring system can consider age: 1) the system can be split into different scorecards depending on the age of the applicant; and 2) age may be directly scored as a variable. Both features may be present in some systems. Regulation B requires that all credit scoring systems that consider age in either of these ways must be validated (in the language of the regulation, empirically derived, demonstrably and statistically sound (EDDSS)).

1. Age-Split Scorecards: If a system is split into only two cards and one card covers a wide age range that encompasses elderly applicants (applicants 62 or older), the system is treated as considering, but not scoring, age. Typically, the younger scorecard in an age-split system is used for applicants under a specific age between 25 and 30. It de-emphasizes factors such as the number of trade lines and the length of employment, and increases the negative weight of any derogatory information on the credit report. Systems such as these do not raise the issue of assigning a negative factor or value to the age of an elderly applicant. However, if age is directly scored as a variable (whether or not the system is age-split), or if elderly applicants are included in a card with a narrow age range in an age-split system, the system is treated as scoring age.
2. Scorecards that Score Age: If a scorecard scores age directly, in addition to meeting the EDDSS requirement, the creditor must ensure that the age of an elderly applicant is not assigned a negative factor or value. (See the staff commentary at 12 CFR 1002.2(p) and 1002.6(b)(2)). A negative factor or value means utilizing a factor, value, or weight that is less favorable than the creditor's experience warrants or is less favorable than the factor, value, or weight assigned to the most favored age group below the age of 62 (12 CFR 1002.2(v)).

F. Examination for Empirical Derivation and Statistical Soundness

Regulation B requires credit scoring systems that use age to be empirically derived, and demonstrably and statistically sound. This means that they must fulfill the requirements of 12 CFR 1002.2(p)(1)(i) - (iv). Obtain documentation provided by the developer of the system and consult the agency's most recent guidance for making that determination.

Evaluating Responses to Evidence of Disparate Treatment

A. Responses to Comparative Evidence of Disparate Treatment

The following are responses that an institution may offer — separately or in combination — to attempt to explain that the appearance of illegal disparate treatment is misleading, and that no violation has in fact occurred. The responses, if true, may rebut the appearance of disparate treatment. The examiners must evaluate the validity and credibility of the responses.

1. **The institution's personnel were unaware of the prohibited basis identity of the applicant(s)**

   If the institution claims to have been unaware of the prohibited basis identity (race, etc.) of an applicant or neighborhood, ask it to show that the application in question was processed in such a way that the institution's staff that made the decisions could not have learned the prohibited basis identity of the applicant.

   If the product is one for which the institution maintains prohibited basis monitoring information, assume that all employees could have taken those facts into account. Assume the same when there was face-to-face contact between any employee and the consumer.

   If there are other facts about the application from which an ordinary person would have recognized the applicant's prohibited basis identity (for example, the surname is an easily recognizable Hispanic one), assume that the institution's staff drew the same conclusions. If the racial character of a community is in question, ask the institution to provide persuasive evidence why its staff would not know the racial character of any community in its service area.

2. **The difference in treatment was justified by differences in the applicants (applicants not "similarly situated")**

Ask the institution to account for the difference in treatment by pointing out a specific difference between the applicants' qualifications, or some factor not captured in the application but that legitimately makes one applicant more or less attractive to the institution, or some non-prohibited factor related to the processing of their applications. The difference identified by the institution must be one that is important enough to justify the difference in treatment in question, not a meaningless difference.

The factors commonly cited to show that applicants are not similarly situated fall into two groups: those that can be evaluated by how consistently they are handled in other transactions, and those that cannot be evaluated in that way.

a. Verifying "not similarly situated" explanations by consistency

   The appearance of disparate treatment remains if a factor cited by the institution to justify favorable treatment for a control group applicant also exists for an otherwise similar prohibited basis applicant who was treated unfavorably. Similarly, the appearance of disparate treatment remains if a factor cited by the institution to justify unfavorable treatment for a prohibited basis applicant also exists for a control group applicant that got favorable treatment. If this is not so, ask the institution to document that the factor cited in its explanation was used consistently for control group and prohibited basis applicants.

   - Among the responses that should be evaluated this way are:
     - **Customer relationship.** Ask the institution to document that a customer relationship was also sometimes considered to the benefit of prohibited basis applicants and/or that its absence worked against control group customers.
     - **"Loan not saleable or insurable."** If file review is still in progress, be alert for loans approved despite the claimed fatal problem. At a minimum, ask the institution to be able to produce the text of the secondary market or insurer's requirement in question.
     - **Difference in standards or procedures between branches or underwriters.** Ask the institution to provide transactions documenting that each of the two branches or underwriters applied its standards or procedures consistently to both prohibited basis and control group applications it processed, and that each served similar proportions of the prohibited basis group.
     - **Difference in applying the same standard (difference in "strictness")** between underwriter, branches, etc. Ask the institution to provide transactions documenting that the stricter employee, branch, etc., was strict for both prohibited basis and control group applicants and that the other was lenient for both, and that each served similar proportions of the prohibited basis group. The best evidence of this would be prohibited basis applicants who received favorable treatment from the lenient branch and control group applicants who received less favorable treatment from the "strict" branch.
     - **Standards or procedures changed during period reviewed.** Ask the institution to provide transactions documenting that during each period the standards were applied consistently to both prohibited basis and control group applicants.
     - **Employee misunderstood standard or procedure.** Ask the institution to provide transactions documenting that the misunderstanding influenced both prohibited basis and control group applications. If that is not available, find no violation if the misunderstanding is a reasonable mistake.

b. Evaluating "not similarly situated" explanations by other means.

   - If consistency cannot be evaluated, consider an explanation favorably even without examples of its consistent use if:
     - The factor is documented to exist in (or be absent from) the transactions, as claimed by the institution;
     - The factor is one a prudent institution would consider and is consistent with the institution's policies and procedures;
     - File review found no evidence that the factor is applied selectively on a prohibited basis (in other words, the institution's explanation is "not inconsistent with available information"); and
     - The institution's description of the transaction is generally consistent and reasonable.
   - Some factors that may be impossible to compare for consistency are:
     - **Unusual underwriting standard.** Ask the institution to show that the standard is prudent. If the standard is prudent and not inconsistent with other information, accept this explanation even though there is no documentation that it is used consistently.
     - **"Close calls."** The institution may claim that underwriters' opposite decisions on similar applicants reflects legitimate discretion that the examiners should not second guess. That is not an acceptable explanation for identical applicants

with different results, but is acceptable when the applicants have differing strengths and weaknesses that different underwriters might reasonably weigh differently. However, do not accept the explanation if other files reveal that these "strengths" or "weaknesses" are counted or ignored selectively on a prohibited basis.

- "**Character loan."** Expect the institution to identify a specific history or specific facts that make the applicant treated favorably a better risk than those treated less favorably.
- **"Accommodation loan."** There are many legitimate reasons that may make a transaction appealing to an institution apart from the familiar qualifications demanded by the secondary market and insurers. For example, a consumer may be related to or referred by an important customer, be a political or entertainment figure who would bring prestige to the institution, be an employee of an important business customer, etc. It is not illegal discrimination to make a loan to an otherwise unqualified control group applicant who has such attributes while denying a loan to an otherwise similar prohibited basis applicant without them. However, be skeptical when the institution cites reasons for "accommodations" that an ordinary prudent institution would not value.
- **"Gut feeling."** Be skeptical when institutions justify an approval or denial by a general perception or reaction to the consumer. Such a perception or reaction may be linked to a racial or other stereotype that legally must not influence credit decisions. Ask whether any specific event or fact generated the reaction. Often, the institution can cite something specific that made him or her confident or uncomfortable about the consumer. There is no discrimination if it is credible that the institution indeed considered such a factor and did not apply it selectively on a prohibited basis.

c. Follow up customer contacts

- If the institution's explanation of the handling of a particular transaction is based on consumer traits, actions, or desires not evident from the file, consider obtaining agency authorization to contact the consumer to verify the institution's description. Such contacts need not be limited to possible victims of discrimination, but can include control group applicants or other witnesses.

3. The different results stemmed from an inadvertent error

If the institution claims an identified error such as miscalculation or misunderstanding caused the favorable or unfavorable result in question, evaluate whether the facts support the assertion that such an event occurred.

If the institution claims an unidentified error caused the favorable or unfavorable result in question, expect the institution to provide evidence that discrimination is inconsistent with its demonstrated conduct, and therefore that discrimination is the less logical interpretation of the situation. Consider the context (as described below).

4. The apparent disparate treatment on a prohibited basis is a misleading portion of a larger pattern of random inconsistencies

Ask the institution to provide evidence that the unfavorable treatment is not limited to the prohibited basis group and that the favorable treatment is not limited to the control group. Without such examples, do not accept an institution's unsupported claim that otherwise inexplicable differences in treatment are distributed randomly.

If the institution can document that similarly situated prohibited basis group applicants received the favorable treatment in question approximately as frequently and in comparable degree as the control group applicants, conclude there is no violation.

NOTE: *Transactions are relevant to "random inconsistency" only if they are "similarly situated" to those apparently treated unequally.*

5. Loan terms and conditions

The same analyses described in the preceding sections with regard to decisions to approve or deny loans also apply to pricing differences. Risks and costs are legitimate considerations in setting prices and other terms and conditions of loan products. However, generalized reference by the institution to "cost factors" is insufficient to explain pricing differences.

If the institution claims that specific borrowers received different terms or conditions because of cost or risk considerations, ask the institution to be able to identify specific risk or cost differences between them.

If the institution claims that specific borrowers received different terms or conditions because they were not similarly situated as negotiators, consider whether application records might provide relevant evidence. If the records are not helpful, consider seeking authorization to contact consumers to learn whether the institution in fact behaved comparably toward prohibited basis and control group consumers. The contacts would be to learn such information as the institution's opening quote of terms to the consumer and the progress of the negotiations.

If the institution responds that an average price difference between the control and prohibited basis groups is based on cost or risk factors, ask it to identify specific risk or cost differences between individual control group

applicants with the lowest rates and prohibited basis group applicants with the highest rates that are significant enough to justify the pricing differences between them. If the distinguishing factors cited by the institution are legitimate and verifiable as described in the sections above, remove those applications from the average price calculation. If the average prices for the remaining control group and prohibited basis group members still differ more than minimally, consult agency supervisory staff about further analysis. Findings or violations based on disparate treatment ~~or disparate impact~~ regarding cost or risk factors should be discussed with agency supervisory staff.

B. Responses to Overt Evidence of Disparate Treatment

1. Descriptive references vs. lending considerations

A reference to race, gender, etc., does not constitute a violation if it is merely descriptive — for example, "the applicant was young." In contrast, when the reference reveals that the prohibited factor influenced the institution's decisions and/or consumer behavior, treat the situation as an apparent violation to which the institution must respond.

2. Personal opinions vs. lending considerations

If an employee involved with credit availability states unfavorable views regarding a racial group, gender, etc., but does not explicitly relate those views to credit decisions, review that employee's credit decisions for possible disparate treatment of the prohibited basis group described unfavorably. If there are no instances of apparent disparate treatment, treat the employee's views as permissible private opinions. Inform the institution that such views create a risk of future violations.

3. Stereotypes related to credit decisions

There is an apparent violation when a prohibited factor influences a credit decision through a stereotype related to creditworthiness — for example, a loan denial because "a single woman could not maintain a large house." If the stereotyped beliefs are offered as "explanations" for unfavorable treatment, regard such unfavorable treatment as apparent illegal disparate treatment. If the stereotype is only a general observation unrelated to particular transactions, review that employee's credit decisions for possible disparate treatment of the prohibited basis group in question. Inform the institution that such views create a risk of future violations.

4. Indirect reference to a prohibited factor

If negative views related to creditworthiness are described in non-prohibited terms, consider whether the terms would commonly be understood as surrogates for prohibited terms. If so, treat the situation as if explicit prohibited basis terms were used. For example, an institution's statement that "It's too risky to lend north of 110th Street" might be reasonably interpreted as a refusal to lend because of race if that portion of the institution's lending area north of 110th Street were predominantly black and the area south, white.

5. Lawful use of a prohibited factor

a. Special Purpose Credit Program (SPCP)

If an institution claims that its use of a prohibited factor is lawful because it is operating an SPCP, ask the institution to document that its program conforms to the requirements of Regulation B. An SPCP must be defined in a written plan that existed before the institution made any decisions on loan applications under the program. The written plan must:

- demonstrate that the program will benefit persons who would otherwise be denied credit or receive credit on less favorable terms; and
- state the time period the program will be in effect or when it will be re-evaluated.

No provision of an SPCP should deprive people who are not part of the target group of rights or opportunities they otherwise would have. Qualified programs operating on an otherwise-prohibited basis will not be cited as a violation.

NOTE: *Advise the institution that an agency finding that a program is a lawful SPCP is not absolute security against legal challenge by private parties. Suggest that an institution concerned about legal challenge from other quarters use exclusions or limitations that are not prohibited by ECOA or the FHAct, such as "first-time home buyer."*

b. Second review program

Such programs are permissible if they do no more than ensure that lending standards are applied fairly and uniformly to all applicants. For example, it is permissible to review the proposed denial of applicants who are members of a prohibited basis group by comparing their applications to the approved applications of similarly qualified individuals who are in the control group to determine if the applications were evaluated consistently.

Ask the institution to demonstrate that the program is a safety net that merely attempts to prevent discrimination, and does not involve underwriting terms or practices that are preferential on a prohibited basis.

Statements indicating that the mission of the program is to apply different standards or efforts on behalf of a particular racial or other group constitute overt evidence of disparate treatment. Similarly, there is an apparent violation if comparative analysis of applicants who are processed through the second review and those who are not discloses dual standards related to the prohibited basis.

c. Affirmative marketing/advertising program:

Affirmative advertising and marketing efforts that do not involve application of different lending standards are permissible under both the ECOA and the FHAct.

For example, special outreach to a minority community would be permissible.

Identifying Marginal Transactions

These procedures are intended to assist an examiner in identifying denied and approved applications that were not either clearly qualified or unqualified, i.e., marginal transactions.

A. Marginal Denials

Denied applications with any or all the following characteristics are "marginal." Such denials are compared to marginal approved applications. Marginal denied applications include those that:

- Were close to satisfying the requirement that the adverse action notice said was the reason for denial;
- Were denied by the institution's rigid interpretation of inconsequential processing requirements;
- Were denied quickly for a reason that normally would take a longer time for an underwriter to evaluate;
- Involved an unfavorable subjective evaluation of facts that another person might reasonably have interpreted more favorably (for example, whether late payments actually showed a "pattern," or whether an explanation for a break in employment was "credible");
- Resulted from the institution's failure to take reasonable steps to obtain necessary information;
- Received unfavorable treatment as the result of a departure from customary practices or stated policies. For example, if it is the institution's stated policy to request an explanation of derogatory credit information, a failure to do so for a prohibited basis applicant would be a departure from customary practices or stated policies even if the derogatory information seems to be egregious;
- Were similar to an approved control group applicant who received unusual consideration or service, but were not provided such consideration or service;
- Received unfavorable treatment (for example, were denied or given various conditions or more processing obstacles) but appeared fully to meet the institution's stated requirements for favorable treatment (for example, approval on the terms sought);
- Received unfavorable treatment related to a policy or practice that was vague, and/or the file lacked documentation on the applicant's qualifications related to the reason for denial or other factor;
- Met common secondary market or industry standards even though failing to meet the institution's more rigid standards;
- Had a strength that a prudent institution might believe outweighed the weaknesses cited as the basis for denial;
- Had a history of previously meeting a monthly housing obligation equivalent to or higher than the proposed debt; and/or
- Were denied for an apparently "serious" deficiency that might easily have been overcome. For example, an applicant's total debt ratio of 50 percent might appear grossly to exceed the institutions guideline of 36 percent, but this may in fact be easily corrected if the application lists assets to pay off sufficient non-housing debts to reduce the ratio to the guideline, or if the institution were to count excluded part-time earnings described in the application.

B. Marginal Approvals

Approved applications with any or all of the following characteristics are "marginal." Such approvals are compared to marginal denied applications. Marginal approvals include those:

- Whose qualifications satisfied the institution's stated standard, but very narrowly;
- That bypassed stated processing requirements (such as verifications or deadlines);
- For which stated creditworthiness requirements were relaxed or waived;
- That, if the institution's own standards are not clear, fell short of common secondary market or industry lending standards;
- That a prudent conservative institution might have denied;
- Whose qualifications were raised to a qualifying level by assistance, proposals, counteroffers, favorable characterizations or questionable qualifications, etc.; and/or
- That in any way received unusual service or consideration that facilitated obtaining the credit.

Potential Scoping Information

As part of the scoping process described in Part I of the procedures, examiners will need to gather documents and information to sufficiently identify their focal points for review. Below is a list of suggested information that examiners may wish to gather internally, as well as from the institution itself.

A. Internal Agency Documents and Records

1. Previous examination reports and related work papers for the most recent Compliance / CRA and Safety and Soundness Examinations.
2. Complaint information.
3. Demographic data for the institution's community.

Comment: *The examiner should obtain the most recent agency demographic data, for information on the characteristics of the institution's assessment/market areas.*

B. Information from the institution

Comment: *Prior to beginning a compliance examination, the examiner should request the institution to provide the information outlined below. This request should be made far enough in advance of the on-site phase of the examination to facilitate compliance by the institution. In some institutions, the examiner may not be able to review certain of this information until the on-site examination. The examiner should generally request only those items that correspond to the time period(s) being examined.*

Fair Lending Sample Size Tables

Table A
Underwriting (Accept/Deny) Comparisons

	Sample 1 Prohibited Basis Denials			Sample 2 Control Group Approvals		
Number of Denials or Approvals	5–50	51–150	>150	20–50	51–250	>250
Minimum to Review	All	51	75	20	51	100
Maximum to Review	50	100	150	5x prohibited basis sample (up to 50)	5x prohibited basis sample (up to 125)	5x prohibited basis sample (up to 300)

Table B
Terms and Conditions Comparisons

	Sample 1 Prohibited Basis Approvals			Sample 2 Control Group Approvals		
Number of Approvals	5–25	26–100	>150	20–50	51–250	>250
Minimum to Review	All	26	50	20	40	60
Maximum to Review	25	50	75	5x prohibited basis sample (up to 50)	5x prohibited basis sample (up to 75)	5x prohibited basis sample (up to 100)

Explanatory Notes to Sample Size Tables

1. Examiners should not follow Table B when conducting a pricing review that involves a regression analysis. Consult with agency supervisory staff for specific protocol in these cases.
2. When performing both underwriting and terms and conditions comparisons, use the same control group approval sample for both tasks.
3. If there are fewer than 5 prohibited basis denials or 20 control group approvals, refer to "Sample Size" instructions in the procedures.
4. "Minimum" and "maximum" sample sizes: select a sample size between the minimum and maximum numbers identified above. Examiners should base the size of their review on the level of risk identified during the preplanning and scoping procedures. Once the sample size has been determined, select individual transactions judgmentally. Refer to procedures.
5. If two prohibited basis groups (e.g., black and Hispanic) are being compared against one control group, select a control group that is 5 times greater than the larger prohibited basis group sample, up to the maximum.
6. Where the institution's discrimination risk profile identifies significant discrepancies in withdrawal/incomplete activity between control and prohibited basis groups, or where the number of marginal prohibited basis group files available for sampling is small, an examiner may consider supplementing samples by applying the following rules:
   - If prohibited basis group withdrawals/incompletes occur after the applicant has received an offer of credit that includes pricing terms, this is a reporting error under Regulation C (the institution should have reported the application as approved but not accepted) and therefore these applications should be included as prohibited basis group approvals in a terms and conditions comparative file analysis.
   - If prohibited basis group incompletes occur due to lack of an applicant response with respect to an item that would give rise to a denial reason, then include them as denials for that reason when conducting an underwriting comparative file analysis.

1. Institution's Compliance Program (For examinations that will include analysis of the institution's compliance program.)
   a. Organization charts identifying those individuals who have lending responsibilities or compliance, HMDA or CRA responsibilities, together with job descriptions for each such position.
   b. Lists of any pending litigation or administrative proceedings concerning fair lending matters.
   c. Results of self-evaluations or self-tests (where the institution chooses to share self-test results), copies of audit or compliance reviews of the institution's program for compliance with fair lending laws and regulations, including both internal and independent audits.

      NOTE: *The request should advise the institution that it is not required to disclose the report or results of any self-tests of the type protected under amendments to ECOA and the FHAct programs.*
   d. Complaint file.
   e. Any written or printed statements describing the institution's fair lending policies and/or procedures.
   f. Training materials related to fair lending issues including records of attendance.
   g. Records detailing policy exceptions or overrides, exception reporting and monitoring processes.
2. Lending Policies / Loan Volume
   a. Internal underwriting guidelines and lending policies for all consumer and commercial loan products.

      Comment: *If guidelines or policies differ by branch or other* geographic *location, request copies of each variation.*
   b. A description of any credit scoring system(s) in use now or during the exam period.

      Comment: *Inquire as to whether a vendor or in-house system is used; the date of the last verification; the factors relied on to construct any in-house system and, if applicable, any judgmental criteria used in conjunction with the scoring system.*
   c. Pricing policies for each loan product, and for both direct and indirect loans.

      Comment: *The institution should be specifically asked whether its pricing policies for any loan products include the use of "overages". The request should also ask whether the institution offers any "sub-prime" loan products or otherwise uses any form of risk-based pricing. A similar inquiry should be made regarding the use of any cost-based pricing. If any of these three forms are or have been in use since the last exam, the institution should provide pricing policy and practice details for each affected product, including the institution's criteria for differentiating between each risk or cost level and any policies regarding overages. Regarding indirect lending, the institution should be asked to provide any forms of agreement (including compensation) with brokers/dealers, together with a description of the roles that both the institution and the dealer/broker play in each stage of the lending process.*
   d. A description of each form of compensation plan for all lending personnel and managers.
   e. Advertising copy for all loan products.
   f. The most recent HMDA / LAR, including unreported data if available.

      Comment: *The integrity of the institution's HMDA-LAR data should be verified prior to the pre-examination analysis.*
   g. Any existing loan registers for each non-HMDA loan product.

      Comment: *Loan registers for the 3 month period preceding the date of the examination, together with any available lists of declined loan applicants for the same period should be requested. Registers / lists should contain, to the extent available, the complete name and address of loan applicants and applicable loan terms, including loan amount, interest rate, fees, repayment schedule and collateral codes.*
   h. A description of any application or loan-level data bases maintained, including a *description* of all data fields within the database or that can be linked at the loan-level.
   i. Forms used in the application and credit evaluation process for each loan product.

      Comment: *At a minimum, this request should include all types of credit applications, forms requesting financial information, underwriter worksheets, any form used for the collection of monitoring information, and any quality control or second review forms or worksheets.*
   j. Lists of service providers.

      Comment: *Service providers may include: brokers, realtors, real estate developers, appraisers, underwriters, home improvement contractors and private* mortgage *insurance companies. Request the full name and address and geographic area served by each provider. Also request documentation as to any fair lending requirements imposed on, or commitments required of, any of the institution's service providers.*
   k. Addresses of any Internet Site(s)

      Comment: *Internet "Home Pages" or similar sites that an institution may have on the Internet may provide* information *concerning the availability of credit, or means for obtaining it. All such information must comply with the nondiscrimination requirements of the fair lending laws. In view of the increasing capability to conduct transactions on the Internet, it is extremely important for examiners to review an institution's Internet sites to ensure that all of the information or*

procedures set forth therein are in compliance with any applicable provisions of the fair lending statutes and regulations.

3. Community Information
   a. Demographic information prepared or used by the institution.
   b. Any fair lending complaints received and institution responses thereto.

Special Analyses

These procedures are intended to assist examiners who encounter ~~disproportionate adverse impact violations,~~ discriminatory pre-application screening and possible discriminatory marketing.

~~**A. Disproportionate Adverse Impact Violations**~~

~~When all five conditions below exist, consult within your agency to determine whether to present the situation to the institution and solicit the institution's response. Note that condition 5 can be satisfied by either of two alternatives.~~

~~The contacts between examiners and institutions described in this section are information-gathering contacts within the context of the examination and are not intended to serve as the formal notices and opportunities for response that an agency's enforcement process might provide. Also, the five conditions are not intended as authoritative statements of the legal elements of a disproportionate adverse impact proof of discrimination; they are paraphrases intended to give examiners practical guidance on situations that call for more scrutiny and on what additional information is relevant.~~

~~***NOTE:** Even if it appears likely that a policy or criterion causes a disproportionate adverse impact on a prohibited basis (condition 3), consult agency supervisory staff if the policy or criterion is obviously related to predicting creditworthiness and is used in a way that is commensurate with its relationship to creditworthiness, or is obviously related to some other basic aspect of prudent lending, and there appears to be no equally effective alternative for it. Examples are reliance on credit reports or use of debt-to-income ratio in a way that appears consistent with industry standards and with a prudent evaluation of credit risk.*~~

~~**Conditions**~~

~~1. A specific policy or criterion is involved.~~

~~The policy or criterion suspected of producing a disproportionate adverse impact on a prohibited basis should be clear enough that the nature of action to correct the situation can be determined.~~

~~***NOTE:** Gross HMDA denial or approval rate disparities are not appropriate for disproportionate adverse impact analysis because they typically cannot be attributed to a specific policy or criterion.*~~

~~2. The policy or criterion on its stated terms is neutral for prohibited bases.~~

~~3. The policy or criterion falls disproportionately on applicants or borrowers in a prohibited basis group.~~

~~The difference between the rate at which prohibited basis group members are harmed or excluded by the policy or criterion and the rate for control group members must be large enough that it is unlikely that it could have occurred by chance. If there is reason to suspect a significant disproportionate adverse impact may exist, consult with agency supervisory staff as appropriate.~~

~~4. There is a causal relationship between the policy or criterion and the adverse result.~~

~~The link between the policy or criterion and the harmful or exclusionary effect must not be speculative. It must be clear that changing or terminating the policy or criterion would reduce the disproportion in the adverse result.~~

~~5. **Either a or b:**~~

~~a. The policy or criterion has no clear rationale, or appears to exist merely for convenience or to avoid a minimal expense, or is far removed from common sense or standard industry underwriting considerations or lending practices.~~

~~The legal doctrine of disproportionate adverse impact provides that the policy or criterion that causes the impact must be justified by "business necessity" if the institution is to avoid a violation. There is very little authoritative legal interpretation of that term with regard to lending, but that should not stop examiners from making the preliminary inquiries called for in these procedures. For example, the rationale is generally not clear for basing credit decisions on factors such as location of residence, income level (per se rather than relative to debt), and accounts with a finance company. If prohibited basis group applicants were denied loans more frequently than control group applicants because they failed an institution's minimum income requirement, it would appear that the first four conditions plus 5a existed; therefore, the examiners should consult within their agency about obtaining the institution's response, as described in the next section below.~~

~~b. Alternatively, even if there is a sound justification for the policy, it appears that there may be an equally~~

effective alternative for accomplishing the same objective with a smaller disproportionate adverse impact.

- The law does not require an institution to abandon a policy or criterion that is clearly the most effective method of accomplishing a legitimate business objective. However, if an alternative that is approximately equally effective is available that would cause a less severe adverse impact, the policy or criterion in question may constitute be a violation.
- At any stage of the analysis of possible disproportionate adverse impact, if there appears to be such an alternative, and the first four conditions exist, consult within the agency how to evaluate whether the alternative would be equally effective and would cause a less severe impact. If the conclusion is that it would, solicit a response from the institution, as described in the next section below.

Obtaining the institution's response

If the first four conditions plus either 5a or 5b appear to exist, consult with agency supervisory staff about whether and how to inform the institution of the situation and solicit the institution's response. The communication with the institution may include the following:

- The specific neutral policy or criterion that appears to cause a disproportionate adverse impact.
- How the examiners learned about the policy.
- How widely the examiners understand it to be implemented.
- How strictly they understand it to be applied.
- The prohibited basis on which the impact occurs.
- The magnitude of the impact.
- The nature of the injury to individuals.
- The data from which the impact was computed.
- The communication should request that the institution provide any information supporting the business justification for the policy and request that the institution describe any alternatives it considered before adopting the policy or criterion at issue.

Evaluating and following up on the response

The analyses of "business necessity" and "less discriminatory alternative" tend to converge because of the close relationship of the questions of what purpose the policy or criterion serves and whether it is the most effective means to accomplish that purpose.

Evaluate whether the institution's response persuasively contradicts the existence of the significant disparity or establishes a business justification. Consult with agency supervisory staff, as appropriate.

Discriminatory Pre-Application Screening

Obtain an explanation for any:

Withdrawals by applicants in prohibited basis groups without documentation of consumer intent to withdraw;

Denials of applicants in prohibited basis groups without any documentation of applicant qualifications; or

On a prohibited basis, selectively quoting unfavorable terms (for example, high fees or down payment requirements) to prospective applicants, or quoting unfavorable terms to all prospective applicants but waiving such terms for control group applicants. (Evidence of this might be found in withdrawn or incomplete files.)

Obtain explanations for any delays between application and action dates on a prohibited basis

If the institution cannot explain the situations, examiners should consider obtaining authorization from their agency to contact the consumers to verify the institution's description of the transactions. Information from the consumer may help determine whether a violation occurred.

In some instances, such as possible "prescreening" of applicants by institution personnel, the results of the procedures discussed so far, including interviews with consumers, may be inconclusive in determining whether a violation has occurred. In those cases, examiners should, if authorized by their agency, consult with agency supervisory staff regarding the possible use of "testers" who would pose as apparently similarly situated applicants, differing only as to race or other applicable prohibited basis characteristic, to determine and compare how the institution treats them in the application process.

C. Possible Discriminatory Marketing

1. Obtain full documentation of the nature and extent, together with management's explanation, of any:
   - Prohibited basis limitations stated in advertisements;
   - Code words in advertisements that convey prohibited limitations; or
   - Advertising patterns or practices that a reasonable person would believe indicate prohibited basis consumers are less desirable or are only eligible for certain products.
2. Obtain full documentation as to the nature and extent, together with management's explanation, for any situation in which the institution, despite the availability of other options in the market:
   - Advertises only in media serving either minority or non-minority areas of the market;
   - Markets through brokers or other agents that the institution knows, or could reasonably be expected to

know, to serve only one racial or ethnic group in the market; or

- Utilizes mailing or other distribution lists or other marketing techniques for pre-screened or other offerings of residential loan products* that:
  - Explicitly exclude groups of prospective borrowers on a prohibited basis; or
  - Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have demonstrably higher percentages of minority group residents than does the remainder of the marketing area, but which have income and other credit-related characteristics similar to the geographies that were targeted for marketing; or
- Offer different products to such geographies, especially if sub-prime products are primarily marketed to racial or ethnic minorities.

  ***NOTE:** Pre-screened solicitation of potential applicants on a prohibited basis does not violate ECOA. Such solicitations are, however, covered by the FHAct. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products*.

3. Evaluate management's response particularly with regard to the credibility of any nondiscriminatory reasons offered as explanations for any of the foregoing practices. Refer to *Evaluating Responses to Evidence of Disparate Treatment* elsewhere in this **Appendix** for guidance.

Using Self-Tests and Self-Evaluations to Streamline the Examination

Institutions may find it advantageous to conduct self-tests or self-evaluations to measure or monitor their compliance with ECOA and Regulation B. A self-test is a program, practice or study that is designed and specifically used to assess the institution's compliance with fair lending laws that creates data not available or derived from loan, application or other records related to credit transactions (12 CFR 1002.15(b)(1) and 24 CFR 100.140-100.148). For example, using testers to determine whether there is disparate treatment in the pre-application stage of credit shopping may constitute a self-test. The information set forth in 12 CFR 1002.15(b)(2) and 24 CFR 100.142(a) is privileged unless an institution voluntarily discloses the report or results or otherwise forfeits the privilege. A self-evaluation, while generally having the same purpose as a self-test, does not create any new data or factual information, but uses data readily available in loan or application files and other records used in credit transactions and, therefore, does not meet the self-test definition.

Examiners should not request any information privileged under 12 CFR 1002.15(b)(2) and 24 CFR 100.142(a), related to self-tests. If the institution discloses the results of any self-tests, or has performed any self-evaluations, and examiners can confirm the reliability and appropriateness of the self-tests or self-evaluations (or even parts of them), they need not repeat those tasks.

***NOTE:** When the term self-evaluation is used below, it is meant to include self-tests where the institution has voluntarily disclosed the report or results.*

If the institution has performed a self-evaluation of any of the product(s) selected for examination, obtain a copy thereof and proceed through the remaining steps of this section on *Streamlining the Examination*.

Determine whether the research and analysis of the planned examination would duplicate the institution's own efforts. If the answers to Questions A and B below are both Yes, each successive Yes answer to Questions C through L indicates that the institution's work up to that point can serve as a basis for eliminating examination steps.

If the answer to either Question A or B is No, the self-evaluation cannot serve as a basis for eliminating examination steps. However, examiners should still consider the self-evaluation to the degree possible in light of the remaining questions and communicate the findings to the institution so that it can improve its self-evaluation process.

A. Did the transactions covered by the self-evaluation occur not longer ago than two years prior to the examination? If the self-evaluation covered more than two years prior to the examination incorporate only results from transactions in the most recent two years.

B. Did it cover the same product, prohibited basis, decision center, and stage of the lending process (for example, underwriting, setting of loan terms) as the planned examination?

C. Did the self-evaluation include comparative file review?

   ***NOTE:** One type of "comparative file review" is statistical modeling to determine whether similar control group and prohibited basis group applicants were treated similarly. If an institution offers self-evaluation results based on a statistical model, consult appropriately within your agency.*

D. Were control and prohibited basis groups defined accurately and consistently with ECOA and/or the FHAct?

E. Were the transactions selected for the self-evaluation chosen so as to focus on marginal applicants or, in the alternative, selected randomly?

F. Were the data analyzed (whether abstracted from files or obtained from electronic databases) accurate? Were those data actually relied on by the credit decision makers at the time of the decisions?

   To answer these two questions and Question G below, for the institution's control group sample and each of its prohibited basis group samples, request to review 10% (but not more than 50 for each group) of the transactions covered by the self-evaluation. For example, if the

institution's self-evaluation reviewed 250 control group and 75 prohibited basis group transactions, plan to verify the data for 25 control group and seven prohibited basis group transactions.

G. Did the 10% sample reviewed for Question F also show that customer assistance and institution judgment that assisted or enabled applicants to qualify were recorded systematically and accurately and were compared for differences on any prohibited bases?

H. Were prohibited basis group applicants' qualifications related to the underwriting factor in question compared to corresponding qualifications of control group approvals? Specifically, for self-evaluations of approve/deny decisions, were the denied applicants' qualifications related to the stated reason for denial compared to the corresponding qualifications for approved applicants?

I. Did the self-evaluation sample cover at least as many transactions at the initial stage of review as examiners would initially have reviewed using the sampling guidance in these procedures?

If the institution's samples are significantly smaller than those in the sampling guidance but its methodology otherwise is sound, review additional transactions until the numbers of reviewed control group and prohibited basis group transactions equal the minimums for the initial stage of review in the sampling guidance.

J. Did the self-evaluation identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?

K. Were explanations solicited for such instances from the persons responsible for the decisions?

L. Were the reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment supported by legitimate, persuasive facts or reasoning?

If the questions above are answered "Yes", incorporate the findings of the self-evaluation (whether supporting compliance or violations) into the examination findings. Indicate that those findings are based on verified data from the institution's self-evaluation. In addition, consult appropriately within the agency regarding whether or not to conduct corroborative file analyses in addition to those performed by the institution.

If not all of the questions in the section above are answered "Yes", resume the examination procedures at the point where the institution's reliable work would not be duplicated. In other words, use the reliable portion of the self-evaluation and correspondingly reduce independent comparative file review by examiners. For example, if the institution conducted a comparative file review that compared applicants' qualifications without taking account of the reasons they were denied, the examiners could use the qualification data abstracted by the institution (if accurate) but would have to construct independent comparisons structured around the reasons for denial.

References[1]

- *Equal Credit Opportunity Act*
- *Regulation B* (including Supplement I, Official Staff Interpretations)
- *Fair Housing Act*
- *12 CFR Part 338*
- *Home Mortgage Disclosure Act*
- *Regulation C*
- *Interagency Fair Lending Examination Procedures*
- *Appendix to Interagency Fair Lending Examination Procedures*
- *Enforcement Policy Statement*
- *Policy Statement on Discrimination in Lending*

[1] Certain references include references to disparate impact. Consistent with Executive Order (EO) 14281, Restoring Equality of Opportunity and Meritocracy, the FDIC evaluates fair lending for disparate treatment only and not for disparate impact.

Federal Trade Commission Act, Section 5 and Dodd-Frank Wall Street Reform and Consumer Protection Act, Sections 1031 and 1036

Introduction

These examination procedures inform examiners about activities that may constitute unfair, deceptive, or abusive acts or practices and how to evaluate the effectiveness of FDIC-supervised institutions' processes for identifying, measuring, monitoring, and otherwise mitigating the risks associated with them. In this context, unfair, deceptive, or abusive acts or practices are legal standards established pursuant to Section 5 of the Federal Trade Commission Act (FTC Act) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). Throughout these procedures these standards will be referred to, respectively, as "FTC UDAPs" and "Dodd-Frank UDAAPs."

The FDIC utilizes a risk-focused examination approach to promote, assess, and confirm institutions' compliance with FTC UDAPs and/or Dodd-Frank UDAAPs. While FTC UDAPs and/or Dodd-Frank UDAAPs occur infrequently, they may result in significant consumer harm and erode consumer confidence in the financial institution. Heightened risk may be present in situations involving: changes to a bank's products or services; the offering of a complex or atypical product; and marketing and delivery strategies using one or more third party providers.

A FTC UDAP and/or Dodd-Frank UDAAP finding is dependent on the relevant specific facts and circumstances; each institution is different and presents distinct potential risks. Accordingly, examination staff should apply the instructions in these procedures consistently as part of their assessment of institutions. In addition, the FDIC will conduct appropriate legal analysis based on the FTC UDAP and/or Dodd-Frank UDAAP standards, and consider the particular facts and circumstances at each institution to determine whether a violation has occurred.

Background

In 1938, Congress expanded the FTC Act to not only prohibit unfair methods of competition but to also prohibit "unfair or deceptive acts or practices" in or affecting commerce to allow the FTC to directly protect consumers. See 15 U.S.C. § 45(a) (Section 5 of the FTC Act). These procedures provide information regarding the applicability of Section 5 of the FTC Act.

In 2010, Congress passed the Dodd-Frank Act. Section 1036 of the Dodd-Frank Act prohibits a "covered person"[1] from engaging in unfair, deceptive, or abusive acts or practices (Dodd-Frank UDAAP). *See* 12 U.S.C. § 5536. Section 1031 of the Dodd-Frank Act provides authority to the Consumer Financial Protection Bureau (CFPB) to promulgate rules identifying such acts or practices as unfair, deceptive, or abusive in connection with consumer financial products and services generally. *See* 12 U.S.C. § 5531. These procedures also provide information regarding Sections 1031 and 1036 of the Dodd-Frank Act.[2]

The legal standards for "unfair" and "deceptive" under Section 5 of the FTC Act and the Dodd-Frank Act are substantially similar. Further, the legal standards for unfair, deceptive, or abusive are independent of each other. Depending on the facts, an act or practice may be unfair or deceptive or abusive or any combination of the three, or not constitute a violation.

Section 5 of the FTC Act

The banking agencies[3] have authority to enforce Section 5 of the FTC Act for the institutions they supervise and their institution affiliated parties (IAPs). The FDIC has provided notice to state nonmember institutions of its intent to cite them and their IAPs for violations of Section 5 of the FTC Act, and of its intent to take appropriate action pursuant to its authority under Section 8 of the Federal Deposit Insurance Act (FDI Act) when a FTC UDAP violation is cited. The FTC has authority to take action against nonbanks that engage in a FTC UDAP. If a FTC UDAP involves an entity or entities over which more than one agency has enforcement authority such as, for example, the FDIC and the FTC, the agencies may coordinate their enforcement actions. Unlike many consumer protection laws, Section 5 of the FTC Act also applies to transactions that may impact business customers as well as individual consumers.[4]

On March 11, 2004, the FDIC and the Board of Governors of the Federal Reserve System (FRB) issued additional guidance regarding FTC UDAPs prohibited by Section 5 of the FTC

[1] The term "covered person" means (1) any person who engages in offering or providing a consumer financial product or service; and (2) any affiliate of a person described in (1) if such affiliate acts as a service provider to such person. See 12 U.S.C. § 5481(6).

[2] Information on Dodd-Frank and its standards of unfair, deceptive and abusive begin on page VII-1.4.

[3] Federal Deposit Insurance Corporation, Federal Reserve Board, and Office of the Comptroller of the Currency.

[4] *FTC v. IFC Credit Corp.,* 543 F. Supp. 2d 925, 943 (2008): "The FTC has construed the term 'consumer' to include businesses as well as individuals. Deference must be given to the interpretation of the agency charged by Congress with the statute's implementation."

Act.[5] Following the release of the guidance, the FDIC issued examination procedures, which include:

- Standards used to assess whether an act or practice is unfair or deceptive
- Interplay between the FTC Act and other consumer protection statutes
- Examination procedures for determining compliance with the FTC Act standards, including risk assessment procedures that should be followed to determine if transaction testing is warranted
- Best practices for documenting a case
- Corrective actions that should be considered for violations of Section 5 of the FTC Act
- List of resources

NOTE: In August 2014, the FDIC, FRB, CFPB, the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) issued guidance regarding certain consumer credit practices as they relate to Section 5 of the FTC Act. The authority to issue credit practices rules under Section 5 of the FTC Act (e.g., Regulation AA, Credit Practices Rule) for banks, savings associations, and federal credit unions was repealed as a consequence of the Dodd-Frank Act.

Notwithstanding the repeal of such authority, the guidance indicated that the Agencies continue to have supervisory and enforcement authority regarding unfair or deceptive acts or practices, which could include those practices previously addressed in the former credit practices rules. Such practices included: (1) the use of certain provisions in consumer credit contracts, (2) the misrepresentation of the nature or extent of cosigner liability, and (3) the pyramiding of late fees.

The guidance clarifies that institutions should not construe the repeal of these rules to indicate that the unfair or deceptive practices described in these former regulations are permissible. The guidance makes clear that these practices remain subject to Section 5 of the FTC Act and Sections 1031 and 1036 of the Dodd-Frank Act.

Standards for Determining What is Unfair or Deceptive

The legal standard for unfairness is independent of the legal standard for deception. Depending on the facts, an act or practice may be unfair, deceptive, both, or neither.

Section 5 of the FTC Act also applies to commercial transactions and businesses. In applying these statutory factors, the FDIC will identify and take action whenever it finds conduct that is unfair or deceptive, as such conduct that falls well below the high standards of business practice expected of banks and the parties affiliated with them.

FTC UDAPs may also violate other federal or state laws. However, practices that fully comply with consumer protection or other laws may still violate Section 5 of the FTC Act. For additional information, please refer to the "Relationship to Other Laws" section further in this document.

Unfair Acts or Practices

The FDIC applies the same standards as the FTC in determining whether an act or practice is unfair. These standards were first stated in the FTC Policy Statement on Unfairness. An act or practice is unfair when it (1) causes or is likely to cause substantial injury to consumers, (2) cannot be reasonably avoided by consumers, and (3) is not outweighed by countervailing benefits to consumers or to competition. Congress codified the three-part unfairness test in 1994.[6] Public policy may also be considered in the analysis of whether a particular act or practice is unfair. All three of the elements necessary to establish unfairness are discussed further below.

- ***The act or practice must cause or be likely to cause substantial injury to consumers.***
  Substantial injury usually involves monetary harm, but can also include, in certain circumstances, unquantifiable or non-monetary harm. An act or practice that causes a small amount of harm to a large number of people, or a significant amount of harm to a small number of people, may be deemed to cause substantial injury.

  An injury may be substantial if it raises significant risk of concrete harm. Trivial or merely speculative harms are typically insufficient for a finding of substantial injury. Emotional impact and other more subjective types of harm will not ordinarily make a practice unfair.
- ***Consumers must not be reasonably able to avoid the injury.***
  An act or practice is not considered unfair if consumers may reasonably avoid injury. Consumers cannot reasonably avoid injury from an act or practice if it interferes with their ability to effectively make decisions or to take action to avoid injury. This may occur if material information about a product, such as pricing, is modified or withheld until after the consumer has committed to purchasing the product, so that the consumer cannot reasonably avoid the injury. It also may occur where testing reveals that disclosures do not effectively

[5] See FIL-26-2004, Unfair or Deceptive Acts or Practices Under Section 5 of the Federal Trade Commission Act (March 11, 2004).

[6] 15 U.S.C. § 45(n).

explain an act or practice to consumers.[7] A practice may also be unfair where consumers are subject to undue influence or are coerced into purchasing unwanted products or services.

Because consumers should be able to survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory, the question is whether an act or practice unreasonably impairs the consumer's ability to make an informed decision, not whether the consumer could have made a wiser decision. In accordance with FTC case law, the FDIC will not second-guess the wisdom of particular consumer decisions. Instead, the FDIC will consider whether an institution's behavior unreasonably creates an obstacle that impairs the free exercise of consumer decision-making.

The actions that a consumer is expected to take to avoid injury must be reasonable. While a consumer could potentially avoid harm by hiring independent experts to test products in advance or bring legal claims for damages, these actions generally would be too expensive to be practical for individual consumers and, therefore, are not reasonable.

- ***The injury must not be outweighed by countervailing benefits to consumers or to competition.***
  To be unfair, the act or practice must be injurious in its net effects — that is, the injury must not be outweighed by any offsetting consumer or competitive benefits that are also produced by the act or practice. Offsetting consumer or competitive benefits may include lower prices or a wider availability of products and services. Nonetheless, both consumers and competition benefit from preventing unfair acts or practices because prices are likely to better reflect actual transaction costs, and merchants who do not rely on unfair acts or practices are no longer required to compete with those who do. Unfair acts or practices injure both consumers and competitors because consumers who would otherwise have selected a competitor's product are wrongly diverted by the unfair act or practice.

  Costs that would be incurred for remedies or measures to prevent the injury are also taken into account in determining whether an act or practice is unfair. These costs may include the costs to the institution in taking preventive measures and the costs to society as a whole of any increased burden and similar matters.

Public Policy May be Considered

Public policy, as established by statute, regulation, judicial decision, or agency determination, may be considered with all other evidence in determining whether an act or practice is unfair. Public policy considerations by themselves, however, will not serve as the primary basis for determining that an act or practice is unfair. For example, the fact that a particular lending practice violates a state law or a banking regulation may be considered as evidence in determining whether the act or practice is unfair. Conversely, the fact that a particular practice is permitted by statute or regulation may, under some circumstances, be considered as evidence that the practice is not unfair. The requirements of the Truth in Lending Act (TILA), the Truth in Savings Act (TISA), the Fair Credit Reporting Act (FCRA), or the Fair Debt Collection Practices Act (FDCPA) are examples of public policy considerations. However, an institution's compliance with another statute or regulation does not insulate the institution from liability for an unfair act or practice under Section 5 of the FTC Act. Fiduciary responsibilities under state law may clarify public policy for actions, especially those involving trusts, guardianships, unsophisticated consumers, the elderly, or minors. State statutes and regulations that prohibit FTC UDAPs are often aimed at making sure that lenders do not exploit the lack of access to mainstream banking institutions by low-income individuals, the elderly, and minorities.

Deceptive Acts or Practices

A three-part test is used to determine whether a representation, omission, or practice is deceptive. This test was first laid out in the FTC Policy Statement on Deceptive Acts and Practices.[8] First, the representation, omission, or practice must mislead or be likely to mislead the consumer. Second, the consumer's interpretation of the representation, omission, or practice must be reasonable under the circumstances. Third, the misleading representation, omission, or practice must be material.[9] As a general matter, the standards for establishing deception are less burdensome than the standards for establishing unfairness because, under deception, there is no requirement of

[7] The FRB's testing of certain disclosures concluded that consumers cannot reasonably avoid certain payment allocation and billing practices because disclosures fail to adequately explain these practices. See Jeanne M. Hogarth & Ellen A. Merry, *Designing Disclosures to Inform Consumer Financial Decisionmaking: Lessons Learned from Consumer Testing*, Federal Reserve Bulletin (August 2011), https://www.federalreserve.gov/pubs/bulletin/2011/pdf/designingdisclosures2011.pdf (summarizing the outcomes of consumer tests on various financial product disclosures). The FTC discusses potential ways to make electronic disclosures clear and understandable in its "Dot Com Disclosures: How to Make Effective Disclosures in Digital Advertising" (March 2013), available at https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-staff-revises-online-advertising-disclosure-guidelines/130312dotcomdisclosures.pdf.

[8] See FTC Policy Statement on Deceptive Acts and Practices.

[9] See FTC Act Policy Statement on Deceptive Acts and Practices.

substantial injury or the likelihood of substantial injury, or the other elements of unfairness related to consumer injury. The following discusses all three of the elements necessary to establish deception.[10]

- ***There must be a representation, omission, or practice that misleads or is likely to mislead the consumer.***
  An act or practice may be found to be deceptive if there is a representation, omission, or practice that misleads or is likely to mislead a consumer. Deception is not limited to situations in which a consumer has already been misled. Instead, an act or practice may be found to be deceptive if it is *likely to mislead* consumers. A representation may be in the form of express or implied claims or promises and may be written or oral. Omission of information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled. An individual statement, representation, or omission is not evaluated in isolation to determine if it is misleading, but rather in the context of the entire advertisement, transaction, or course of dealing. Acts or practices that have the potential to be deceptive include: making misleading cost or price claims; using bait-and-switch techniques; offering to provide a product or service that is not in fact available; omitting material limitations or conditions from an offer; selling a product unfit for the purposes for which it is sold; and failing to provide promised services.
- ***The act or practice must be considered from the perspective of the reasonable consumer.***
  In determining whether an act or practice is misleading, the consumer's interpretation of or reaction to the representation, omission, or practice must be reasonable under the circumstances. In other words, whether an act or practice is deceptive depends on how a reasonable member of the target audience would interpret the marketing material. When representations or marketing practices are targeted to a specific audience, such as the elderly or the financially unsophisticated, the communication is reviewed from the point of view of a reasonable member of that group.

  If a representation conveys two or more meanings to reasonable consumers and one meaning is misleading, the representation may be deceptive. Moreover, a consumer's interpretation or reaction may indicate that an act or practice is deceptive under the circumstances, even if the consumer's interpretation is not shared by a majority of the consumers in the relevant class, so long as a significant minority of such consumers is misled.

  Written disclosures may be insufficient to correct a misleading statement or representation, particularly where the consumer is directed away from qualifying limitations in the text or is counseled that reading the disclosures is unnecessary. Likewise, oral disclosures or fine print are generally insufficient to cure a misleading headline or prominent written representation. Finally, a deceptive act or practice cannot be cured by subsequent truthful disclosures.
- ***The representation, omission, or practice must be material.***
  A representation, omission, or practice is material if it is likely to affect a consumer's decision to purchase or use a product or service. In general, information about costs, benefits, or restrictions on the use or availability of a product or service is material. When express claims are made with respect to a financial product or service, the claims will be presumed to be material. While intent to deceive is not a required element of proving that an act or practice is deceptive, the materiality of an implied claim will be presumed if it can be shown that the institution intended that the consumer draw certain conclusions based upon the claim.

  Claims made with knowledge that they are false will also be presumed to be material. Omissions will be presumed to be material when the financial institution knew or should have known that the consumer needed the omitted information to make an informed choice about the product or service.

Sections 1031 and 1036 of the Dodd-Frank Act (Dodd-Frank UDAAP)

Title X of the Dodd-Frank Act provides exclusive supervisory authority and primary enforcement authority to the CFPB for insured depository institutions with total assets over $10 billion for the Dodd-Frank UDAAP provisions of Sections 1031 and 1036 of the Dodd-Frank Act.[11] The Dodd-Frank Act

[10] Clear and Conspicuous Disclosures
When evaluating the three-part test for deception, the four "Ps" should be considered: prominence, presentation, placement, and proximity. First, is the statement prominent enough for the consumer to notice? Second, is the information presented in an easy to understand format that does not contradict other information in the package and at a time when the consumer's attention is not distracted elsewhere? Third, is the placement of the information in a location where consumers can be expected to look or hear? Finally, is the information in close proximity to the claim it qualifies? More information is available at: https://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-staff-revises-online-advertising-disclosure-guidelines/130312dotcomdisclosures.pdf.

[11] 12 U.S.C. § 5531; 12 U.S.C. § 5536.

provides the FDIC with supervisory and enforcement authority for Dodd-Frank UDAAP, as well as other Federal consumer financial laws, for state, nonmember banks with total assets of $10 billion or less.[12] As a result of the provisions contained in the Dodd-Frank Act and Section 5 of the FTC Act, the FDIC has supervisory or enforcement authority that includes both FTC UDAP and Dodd-Frank UDAAP in certain situations.[13]

The standards for determining whether an act or practice is unfair or deceptive under the Dodd-Frank Act are substantially similar to the FTC Act standards.[14] Section 1036 of the Dodd-Frank Act prohibits unfair, deceptive, or abusive acts and practices with respect to consumer financial products and services generally.[15] An abusive act or practice is one that:

- Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or
- Takes unreasonable advantage of:
  - A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service; or
  - The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
  - The reasonable reliance by the consumer on a covered person[16] to act in the interests of the consumer.[17]

Unlike the standards for unfair or deception under Section 5 of the FTC Act, where all prongs of the test must be met for there to be a violation, the abusive standard lays out individual, stand-alone tests to determine if an act or practice is abusive. Although abusive acts also may be unfair or deceptive, examiners should be aware that the legal standards for abusive, unfair, and deceptive are independent of each other.

The Role of Consumer Complaints in Identifying Unfair, Deceptive, or Abusive Acts or Practices

Consumer complaints play a key role in the detection of a FTC UDAPs and Dodd-Frank UDAAPs. Consumer complaints have often been an essential source of information for possible FTC UDAPs and Dodd-Frank UDAAPs and can also be an indicator of weaknesses in elements of the institution's compliance management system, such as training, internal controls, or monitoring.

While the absence of complaints does not ensure that FTC UDAPs or Dodd-Frank UDAAPs are not occurring, the presence of complaints may be a red flag indicating that a more detailed review is warranted. This is especially the case when similar complaints are received from several consumers regarding the same product or service. One of the three tests in evaluating an apparent deceptive practice is: "The act or practice must be considered from the perspective of the reasonable consumer." Consumer complaints provide a window into the perspective of the reasonable consumer.

Complaint Resolution Procedures

Examiners should interview institution staff about consumer complaints and the institution's procedures for resolving and monitoring consumer complaints. Examiners should determine whether management has responded promptly and appropriately to consumer complaints. The FDIC expects institutions to be proactive in resolving consumer complaints, as well as monitoring complaints for trends that indicate potential FTC UDAP or Dodd-Frank UDAAP concerns. Institutions should centralize consumer complaint handling and ensure that all complaints are captured, whether they are made via telephone, mail, email, in person, the institution's regulator, text message, live chat, or other methods. In addition to resolving individual complaints, an institution should take action to improve its business practices and compliance management system, when appropriate. The institution's audit and/or monitoring function should also include a review of consumer complaints.

Sources for Identifying Complaints

Consumer complaints can originate from many different sources. The primary sources for complaints are those received directly by the institution and those received by the FDIC National Center for Consumer and Depositor Assistance Consumer Response Unit (Consumer Response Unit). Secondary sources for complaints include State Attorneys General or Banking Departments, the Better Business Bureau, the FTC's Consumer Sentinel database, the CFPB's Consumer Complaint Database, consumer complaint boards, and web blogs. In many cases, complaints have been identified through simple Internet searches with the institution's name or particular product or service that it offers. At times, former employees may post complaints. These can be an important

[12] The Dodd-Frank Act provided the FDIC backup enforcement authority with respect to Dodd-Frank UDAAP over FDIC-supervised institutions with total assets over $10 billion.

[13] The FDIC also has the authority to enforcement any federal law or regulation under the general grant of authority provided by Section 8 of the Federal Deposit Insurance Corporation Act, 12 U.S.C. § 1818.

[14] See 12 U.S.C. § 5531.

[15] See 12 U.S.C. § 5536.

[16] The term "covered person" means (1) any person who engages in offering or providing a consumer financial product or service; and (2) any affiliate of a person described in (1) if such affiliate acts as a service provider to such person. See 12 U.S.C. § 5481(6).

[17] See 12 U.S.C. § 5531(d)(1)-(2).

information source. For institutions that have significant third-party relationships, complaints may have been directed to the third party, rather than to the institution. Examiners should determine if the institution is provided with copies of complaints received by third parties. If they are not, this would be a red flag and should be examined further.

Analyzing Complaints

Examiners should consider conducting transaction testing when consumers repeatedly complain about an institution's product or service. However, even a single complaint may raise valid concerns that would warrant transaction testing. Complaints that allege misleading or false statements, missing disclosure information, excessive fees, inability to reach customer service, or previously undisclosed charges may indicate a possible FTC UDAP or Dodd-Frank UDAAP.[18]

If a large volume of complaints exists, examiners should create a spreadsheet that details the complainant, date, source (i.e., institution, website, etc.), product or service involved, summary of the issue, and action taken by the institution. The spreadsheets can then be used to identify trends by type of product or issue. The Consumer Response Unit can be of assistance during this process by creating spreadsheets for complaints that were received by the FDIC.

When reviewing complaints, examiners should look for trends. While a large volume of complaints may indicate an area of concern, the number of complaints alone is not dispositive of whether a potential FTC UDAP or Dodd-Frank UDAAP exists. Conversely, a small number of complaints does not undermine the seriousness of the allegations that are raised. If even a single complaint raises valid concerns relative to a FTC UDAP or Dodd-Frank UDAAP, a more thorough review may be warranted. It is important to focus on the issues raised in the complaints and the institution's responses, and not just on the number of complaints.

Note also that high rates of chargebacks or refunds regarding a product or service can be indicative of potential FTC UDAP or Dodd-Frank UDAAP violations. This information may not appear in the consumer complaint process.

When reviewing complaints, also look for any complaints lodged against subsidiaries, affiliates, third-parties, and affinity groups regarding activities that involve the institution, a product offered through the institution, or a product offered using the institution's name. While the institution may not be actively involved in the activity, if it is a branded product or product offered through a third-party relationship, the institution can be held responsible and face the same risks as if the activity was housed within the institution. *In re Columbus Bank and Trust Company, First Bank of Delaware, First Bank and Trust (Brookings, South Dakota), and CompuCredit Corporation*[19] is an example of where complaints against a third-party directly related to the institutions and the institutions were held accountable for the activities of the third-party.

Relationship to Other Laws

Unfair, deceptive, or abusive acts or practices that violate the FTC Act or the Dodd-Frank Act may also violate other federal or state laws. These include, but are not limited to, TILA, TISA, the Equal Credit Opportunity Act (ECOA), the Fair Housing Act (FHA), the FDCPA, the FCRA, and laws related to the privacy of consumer financial information. On the other hand, certain practices may violate the FTC Act or the Dodd-Frank Act while complying with the technical requirements of other consumer protection laws. Examiners should consider both possibilities. The following laws may warrant particular attention in this regard:

Truth in Lending Act (TILA)

Pursuant to TILA, creditors must "clearly and conspicuously" disclose the costs and terms of credit. An act or practice that does not comply with these provisions of TILA may also violate the FTC Act or the Dodd-Frank Act. Conversely, a transaction that is in technical compliance with TILA may nevertheless violate the FTC Act or the Dodd-Frank Act. For example, an institution's credit card advertisement may contain all the required TILA disclosures, but limitations or restrictions that are obscured or inadequately disclosed may be considered a FTC UDAP or Dodd-Frank UDAAP.

Truth in Savings Act (TISA)

TISA requires depository institutions to provide interest and fee disclosures for deposit accounts so that consumers may compare deposit products. TISA also provides that advertisements cannot be misleading or inaccurate or misrepresent an institution's deposit contract. As with TILA, an act or practice that does not comply with these provisions may also violate the FTC Act or the Dodd-Frank Act, but transactions that are in technical compliance with TISA may still be considered as unfair, deceptive, or abusive. For example, consumers could be misled by advertisements of "guaranteed" or "lifetime" interest rates when the creditor or depository institution intends to change the rates, even if the disclosures satisfy the technical requirements of TISA.

[18] ***See*** Supervisory Insights FDIC, Supervisory Insights, Winter 2006, Vol. 3, Issue 2, Chasing the Asterisk: A Field Guide to Caveats, Exceptions, Material Misrepresentations, and Other Unfair or Deceptive Acts or Practices.

[19] Available at http://www.fdic.gov.

Equal Credit Opportunity (ECOA) and Fair Housing (FHA) Acts

ECOA prohibits discrimination in any aspect of a credit transaction against persons on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to contract), the fact that an applicant's income derives from any public assistance program, and the fact that the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The FHA prohibits creditors involved in residential real estate transactions from discriminating against any person on the basis of race, color, religion, sex, handicap, familial status, or national origin. ~~FTC UDAPs and Dodd-Frank UDAAPs that target or have a disparate impact on consumers in one of these prohibited basis groups may violate the ECOA or the FHA, as well as the FTC Act or the Dodd-Frank Act.~~ Moreover, some state and local laws address discrimination against additional protected classes, e.g., handicap in non-housing transactions, or sexual orientation. Such conduct may also violate the FTC Act or the Dodd-Frank Act.

Fair Debt Collection Practices Act (FDCPA)

The FDCPA prohibits unfair, deceptive, and abusive practices related to the collection of consumer debts. Although this statute does not apply to institutions that collect their own debts in their own name, failure to adhere to the standards set by the FDCPA may violate FTC UDAP.[20] Moreover, institutions that either affirmatively or through lack of oversight permit a third-party debt collector acting on their behalf to engage in deception, harassment, or threats in the collection of monies due may be exposed to liability for participating in or permitting a FTC UDAP.

Fair Credit Reporting Act (FCRA)

The FCRA contains significant responsibilities for institutions that obtain and use information about consumers to determine the consumer's eligibility for products, services, or employment; share such information among affiliates; and furnish information to consumer reporting agencies. The FCRA was substantially amended with the passage of the Fair and Accurate Credit Transactions Act (FACT Act) in 2003, which contained many new consumer disclosure requirements as well as provisions to address identity theft. Violations of the FCRA may also be considered as a FTC UDAP or Dodd-Frank UDAAP. For example, obtaining and using unsolicited medical information (outside of the exceptions provided by the rule) to make credit decisions may also be considered as unfair.

Privacy of Consumer Financial Information

Regulation P (12 CFR Part 1016.12) prohibits an institution or its affiliates from disclosing a customer's account number or similar access code for a credit card, deposit, or transaction account to a nonaffiliated third party for use in telemarketing, direct mail marketing, or other marketing through electronic mail. There are only three exceptions to this prohibition. A financial institution may disclose its customers' account numbers to: (1) a consumer reporting agency; (2) its agent to market the institution's own products or services, provided that the agent is not authorized to directly initiate charges to the account; or (3) another participant in a private label credit card or an affinity or similar program involving the institution. Depending upon the totality of the circumstances, an institution that does not comply with these requirements may be also engaging in FTC UDAPs.[21]

Examination Procedures

Examination Objectives

1. To assess the quality of the financial institution's compliance management systems, internal controls, and policies and procedures for avoiding unfair, deceptive, or abusive acts or practices.
2. To identify products, services, or activities that materially increase the risk of being unfair, deceptive, or abusive.
3. To gather facts that help determine whether a financial institution's products, services, programs, or operations are likely to be unfair, deceptive, or abusive.

General Guidance

During pre-examination planning, examiners should determine if transaction-related testing is warranted for one or more of the institution's products or services. Also, examiners should be alert to possible FTC UDAPs and Dodd-Frank UDAAPs throughout an examination, including when reviewing specific products or services for compliance with other consumer compliance regulatory requirements.

The following risk assessment and transaction-related examination procedures should be used, as appropriate, to assist examiners in recognizing potential FTC UDAPs and Dodd-Frank UDAAPs, analyzing potential issues, and determining an appropriate response.

Risk Assessment Procedures

The risk assessment process should begin during the pre-examination planning stage, when the institution is first contacted to discuss the Compliance and Information Document Request (CIDR). The CIDR can then be customized to request information that is needed to determine the

[20] The same conduct could also violate Dodd-Frank UDAAP; however, interpretive authority for the Dodd-Frank Act rests with the CFPB.

[21] The same conduct could also violate Dodd-Frank UDAAP; however, interpretive authority for the Dodd-Frank Act rests with the CFPB.

institution's risk profile for potential FTC UDAPs and Dodd-Frank UDAAPs.

Institutions with increased risk: Institutions may have a higher risk profile for potential FTC UDAP or Dodd-Frank UDAAP violations if they introduce new products or services, especially those targeting individuals who are financially unsophisticated, vulnerable to financial abuse, or financially distressed. Risks may increase when an institution introduces a new delivery channel, a complex product, or a new activity, or when staff is not sufficiently qualified or trained. As in other areas, the strength of an institution's CMS, such as strong management controls, effective training, and on-going monitoring, is a mitigating factor.

Institutions with limited risk: Many institutions have low risk profiles for potential FTC UDAP or the Dodd-Frank UDAAP violations and would not generally require transaction testing. These include institutions that do not offer products associated with increased incidence of complaints, violations, chargebacks, or risk of consumer harm; have not introduced any new products; and have no consumer complaints (or a limited number of consumer complaints that are unrelated to FTC UDAP or Dodd-Frank UDAAP). However, examiners should be alert to possible FTC UDAPs or Dodd-Frank UDAAPs throughout an examination, including when reviewing specific products or services for compliance with other consumer compliance regulatory requirements.

Transaction-Related Examination Procedures

If, upon conclusion of the risk assessment procedures, risks requiring further investigation are noted, examiners should conduct transaction testing, as necessary. Use examiner judgment in deciding whether to sample individual products, services, or marketing programs. Increase the sample to achieve confidence that all aspects of the financial institution's products and services are sufficiently reviewed.

An FTC UDAP or Dodd-Frank UDAAP analysis is fact-specific and cannot be based on a particular checklist; however, transaction-related examination procedures fall into the following general categories: marketing and disclosures, availability of credit, availability of advertised terms, repricing and other changes, servicing, and collections.

The following are examples of items that should be reviewed, as applicable:

- Advertisement and marketing documentation
- New product development documentation
- Documentation of software testing
- Procedural manuals, including those for servicing and collections
- Customer disclosures, notices, agreements, and periodic statements for each product and service reviewed
- Account statements
- Agreements with third-parties
- Compensation programs
- Promotional materials
- Telemarketing and customer service scripts
- Recorded calls for telemarketing or collections
- Organization charts and process workflows
- Relevant marketing and advertising materials, including website pages
- Relevant disclosures and customer contracts
- Collection scripts and notices
- Relevant training materials
- Relevant software algorithms or parameters
- Consumer complaint files

Collaboration with Others

Regional Examination Specialists

Examiners should follow field office, regional, and national consultation procedures, including contacting the appropriate Regional Examination Specialists for assistance in determining whether unfair, deceptive, or abusive acts or practices have occurred.

Legal Division (Legal)

Following applicable protocol, examiners are encouraged to consult with Regional or Washington Office Legal, as appropriate, as early as possible when potential violations of the FTC Act or the Dodd-Frank Act are identified. Legal staff can provide valuable assistance to examiners during the onsite examination, including advising examiners on the types of documentation that should be obtained and developing interview questions.

Risk Management Supervision

Following regional protocol, examiners should consider if a potential violation of the FTC Act or the Dodd-Frank Act could have an impact on the safety and soundness of the bank and alert risk management staff accordingly. This may warrant a joint onsite presence at the institution, request for additional information or other appropriate supervisory action.

Policy and Research Branch

The Policy and Research Branch can provide assistance in conducting an analysis of large amounts of customer data. Examiners should follow regional and Washington consultation procedures in seeking assistance from Policy and Research.

Documentation

Documentation of potential FTC UDAP or Dodd-Frank UDAAP violations is extremely important. The following guidance should be used to facilitate review of a potential violation:

1. Create an inventory of documentary evidence gathered and interviews conducted.
2. Create chronologies or charts to explain complex fact patterns.
3. For printed materials (marketing, solicitations, disclosures), an original, unmarked copy should be maintained.
4. For websites, print copies or save the webpages electronically as soon as possible. Websites are easily altered, so versions of the website that support the case must be preserved by the examiner. When possible save webpages electronically such as a PDF. The electronically saved copy should be formatted such that the following information is included: window title, URL, date, time, page number, total number of pages. In cases where the website includes links for additional information, notate the page succession.
5. If consumer complaints are voluminous, create spreadsheets or summaries. Refer to the Analyzing Complaints section for additional guidance.
6. Indicate the type of institution reports that are available. For those documents received, notate why it was obtained, how it was received, when, and from whom.
7. Maintain a final, typed version of the interview notes. All examiners that participated in the interview should review the notes and attest to their accuracy. Consider having the interviewee review the notes.
8. During the examination, the examiner should consider the types of corrective actions that may be pursued. For cases where restitution to consumers may be necessary, the examiner should obtain information needed to identify and estimate restitution.
9. If the potential violation involves an affiliate or third party, obtain the information and documentation needed to determine whether an affiliate is an IAP. Refer to the IAP examination procedures for further information and guidance.
10. The following includes a list of other documents that are generally needed:
    - Income reports
    - Third-party contracts
    - Relevant board minutes
    - Relevant audit reports
    - Due diligence records
    - Training materials
    - Telemarketing and customer service scripts
    - Software parameters
    - Account agreements
    - Collection scripts and notices
    - Consumer communications and notifications
    - Billing Statements

Corrective Actions to be Considered for Violations of Section 5 FTC Act or Sections 1031 and 1036 of the Dodd-Frank Act

As with any violation of law or regulation, the response to a violation of Section 5 of the FTC Act and Sections 1031 and 1036 of the Dodd-Frank Act will depend on a number of factors, including:

- The nature of the violation;
- Whether it is a repeat violation or a variation of a previously cited violation;
- The harm, or potential harm, suffered by consumers;
- The number of parties affected; and
- The institution's overall compliance posture and history, both in general and with respect to FTC UDAP and Dodd-Frank UDAAP.

Level 3 or Level 2 violations may result in a downgrade of the institution's compliance and CRA ratings and potentially, the institution's risk management rating. In determining the overall CRA rating for an institution, examiners consider evidence of discrimination or other illegal acts, including violations of Section 5 of the FTC Act or Sections 1031 or 1036 of the Dodd-Frank Act.

In addition to determining a violation's impact on the institution's compliance and CRA ratings, examiners must consider corrective actions that should be taken. These may include requiring the discontinuance of the act or practice, restitution to consumer and business customers, informal or formal enforcement actions, and assessment of a civil money penalty. Examiners should refer to the Formal and Informal Enforcement Actions Manual in the references section below for additional guidance.

List of Resources

This list includes references that are cited in the text, as well as additional resources that may be useful to examiners.

Agency Issuances

- Interagency Guidance: Deposit-Reconciliation Practices (FIL 35-2016).
- Interagency Guidance Regarding Unfair or Deceptive Credit Practices (FIL 44-2014).

- FDIC, *Supervisory Insights, Winter 2008, Vol. 5, Issue 2*, *From the Examiner's Desk: Unfair and Deceptive Acts and Practices: Recent FDIC Experience*
- FDIC, *Supervisory Insights, Winter 2006, Vol. 3, Issue 2*, *Chasing the Asterisk: A Field Guide to Caveats, Exceptions, Material Misrepresentations, and Other Unfair or Deceptive Acts or Practices.*
- FIL 26-2004: *Unfair or Deceptive Acts or Practices by State-Chartered Banks.*
- FTC Policy Statement on Deceptive Acts and Practices.
- FTC Policy Statement on Unfairness.
- FTC's Dot Com Disclosures: How to Make Effective Disclosures in Digital Advertising
- Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 9127 (Feb. 24, 2005).
- CFPB Unfair, Deceptive, or Abusive Acts or Practices (UDAAPs) examination procedures

References

FDIC Formal and Informal Enforcement Actions Manual

FIL-44-2008 *Third-Party Risk: Guidance for Managing Third-Party Risk*

CFPB Enforcement Actions Involving Unfair, Deceptive or Abusive Acts or Practices

FTC Enforcement Actions Involving Unfair or Deceptive Acts or Practices

FTC's Subprime Lending Cases

FTC Unfair or Deceptive Acts or Practices Enforcement Actions: Mortgage Servicing

FTC Unfair or Deceptive Acts or Practices Enforcement Actions: Collection Practices

Other Regulations with Provisions that Relate to Accurate Advertising

12 CFR Part 1026: Regulation Z Truth in Lending

12 CFR Section 1026.16: Open-end advertising

12 CFR Section 1026.24: Closed-end advertising

12 CFR Part 1030: Regulation DD, Truth in Savings Advertising: 12 CFR Section 1030.8

12 CFR Section 1030.11: Additional disclosure requirements for institutions advertising the payment of overdrafts

12 CFR Part 328, Subpart A – Advertisement of Membership

12 CFR Part 328, Subpart B – False Advertising, Misrepresentation of Insured Status, and Misuse of the FDIC's Name or Logo

12 CFR Part 343: Consumer Protection in Sales of Insurance

12 CFR Section 343.40(d): Advertising