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 courts have recognized three methods of proof of lending discrimination under the ECOA and the FHAct:

- Overt evidence of disparate treatment;
- 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

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

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

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.

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, 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 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 senior 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[2] 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.

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.

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

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[3]

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

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.

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

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. <u>Create Applicant Profile Spreadsheet</u>

   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.