



## Managing Fair Lending Risk

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### III. Fair Lending Risk Indicators – Part I

# Fair Lending Risk Indicators



# Overt Indicators



Specific mention of a prohibited basis group;

Inclusion of variables in a credit scoring system;

Statements made by bank personnel or agents; and

Employee statements that reflect attitudes based on prohibited basis.

# Overt Discrimination - Example

## Bank's Loan Policy



**“All loans to closely held corporations shall be guaranteed by the major principals of the corporations and their spouses.”**

# Overt Discrimination - Example

## Account - A

**Age: Anyone of legal age**

**DEMAND DEPOSIT  
ACCOUNT:**

**Benefits Offered:**

- \$6 monthly service charge;
- No minimum balance;
- \$300 overdraft protection coverage

**HELOC Interest Rate- 5.5%**

## Account - B

**AGE: 50 and older**

**DEMAND DEPOSIT  
ACCOUNT:**

**Benefits Offered**

- \$6 monthly service charge;
- No minimum balance;
- \$300 overdraft protection coverage

**HELOC Interest Rate- 4.5%**



# Strategies

Review new or amended lending policies for compliance with fair lending laws

Train lending staff on the fair lending laws as well as the bank's lending policies

## Key Fact to Remember



**Overt discrimination can be based on oral or written statements made by any bank representative.**

# Underwriting Risk Indicators



Significant denial rate disparities on a prohibited basis;

Vague terms for underwriting standards;

High level of exceptions to underwriting policies; and

Limited or no loan file documentation.




# Underwriting - Example

## Bank Loan Policy


### Underwriting Criteria:

- I. We lend to applicants with an **acceptable credit score**.
- II. We lend to applicants with **good credit**.

Loan Officer A	
Acceptable Credit History:	
Beacon Score	620
Late Pays	2 x 60 days
Bankruptcy	2 years



Loan Officer B	
Acceptable Credit History:	
Beacon Score	580
Late Pays	1 x 30 days
Bankruptcy	7 years



# Comparative Evidence - Example

**Bank Loan Policy:**  
Maximum Debt-to-Income Ratio (DTI) = 36%

Applicants	# of Applications approved with DTI Ratios above 36%	# of Applications denied with DTI ratios above 36%
Male	20 / 30 ←	10 / 30
Female	5 / 30 ←	25 / 30

# Strategies

Develop specific and objective underwriting criteria to ensure lenders consistently apply bank standards.

Implement policies and procedures requiring loan officers to document credit decision in loan files.

Periodically review policy exceptions and evaluate whether loan officers document exceptions and the reasons why they were made.

Perform a comparative file analysis of denials and approvals.

## Key Fact to Remember



**If a bank's underwriting process allows discretion, management should implement appropriate policies, procedures, and monitoring to control risk.**

# Pricing Risk Indicators



Broad pricing discretion regarding not only interest rates, but also fees, or points;

Risk-based pricing without objective criteria or that is not applied consistently;

Disparities in the number of higher-priced mortgages or rate spreads on a prohibited basis as reported in the HMDA data; and

Disparities in interest rates and fees on a prohibited basis.

# Pricing - Example

## Loan Policy - Brokers Pricing Standards

- Minimum Credit Score - 640
- DTI Ratio - 38%
- LTV Ratio - 95%
- Loans up to \$100,000 - 6%
- Loans over \$100,000 - 8%
- Broker Compensation - 1%  
up to 3%



# Strategies

## Rate Sheet

Periodically monitor the pricing of loans.

## No Rate Sheet

Implement internal controls, conduct regular monitoring and training, and clearly communicate responsibilities and expectations.

## Loan File Documentation

Require adequate loan documentation.

## Key Fact to Remember



**Focus the pricing reviews on areas where discretion is allowed and determine whether the controls in place are adequate to mitigate fair lending risk.**



# SUMMARY

- **Fair Lending Risk Indicators – Part I:**
  - **Overt Indicators**
  - **Underwriting**
  - **Pricing**

# SUMMARY

- **Review policies and procedures;**
- **Establish or evaluate internal controls;**
- **Conduct regular monitoring and training; and**
- **Clearly communicate responsibilities and expectations.**