FAIR LENDING
September 2017
Presented by:
Leonard Wagers, CPA &
Tricia H. Lynn, CRCM
Interactive Tools

Webinar questions can also be sent to
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Introductions

Leonard Wagers leads CSH’s Risk Management Services group. He has over 25 years of experience conducting internal audit and profitability analysis for financial institutions. His expertise and specialties include: operational auditing, compliance auditing, interest rate risk model validations, internal control evaluation and policy and procedure reviews. Leonard is a Certified Public Accountant (CPA), Chartered Global Management Accountant (CGMA) Certified Financial Services Auditor (CFSA), Certification in Risk Management Assurance (CRMA) and Certified Bank Auditor (CBA).

Tricia Lynn is a Certified Regulatory Compliance Manager (CRCM) with over 15 years of experience. She manages and directs CSH’s regulatory compliance consulting service. Tricia plans and conducts regulatory compliance audits including lending, deposit and the Bank Secrecy Act compliance for our financial institution clients. She assists in performing internal audits of primary banking activities including lending operations, deposit operations and branch operations. Tricia also assists with risk-based loan reviews including credit quality, documentation and compliance requirements. She provides assistance to clients with new product development, marketing reviews, disclosure review and regulatory updates.
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Disclaimer

We are not providing legal advice in this presentation. This information is a compilation of fair lending regulations, best practices, and regulatory guidance. Resources and citations are at the end of the presentation.
Agenda

• Fair Lending Regulations – Which regulations apply?
• CFPB – Where is their focus?
• HMDA data and new fields for fair lending?
• FDIC – REMA (Reasonably Expected Market Area)?
• What do you do with your fair lending analysis?
• Who has responsibility in your institution?
• Don’t forget complaints!
• Is your risk assessment ready?
• What do you do with your self-testing analysis?
• What’s next?
• Questions?
Poll #1

Do you feel confident in your fair lending compliance management program?

* Not really, our program is likely outdated.
* We're okay, but probably should review it.
* We feel it's solid, but want to double check everything is in line.
Fair Lending Regulations

- Equal Credit Opportunity Act (ECOA) Implementing Regulation B – 12 CFR 1002 (Consumer Financial Protection Bureau)
- Fair Housing Act (FHA)
- HUD Final Rule on Disparate Impact
- Unfair, Deceptive or Abusive Acts or Practices (UDAAP)
- Home Mortgage Disclosure Act (HMDA) Regulation C 12 CFR 1003 (Consumer Financial Protection Bureau)
Equal Credit Opportunity Act

The Bureau (CFPB) was given, under the Dodd-Frank Act, responsibility for administering the Equal Credit Opportunity Act (ECOA). ECOA states: “A creditor shall not discriminate against an applicant regarding any aspect of a credit transaction.” The prohibition applies to commercial as well as consumer transactions. AND…

“A creditor shall not make any oral or written statement, in advertising or otherwise, to applicants or prospective applicants that would discourage on a prohibited basis a reasonable person from making or pursuing an application.”
Equal Credit Opportunity Act (cont.)

- Consumer loans
- Commercial loans
- Credit applications
- Underwriting
- Pricing
- Notifications
- Adverse Action
- Appraisals
- Servicing
- Collection
Equal Credit Opportunity Act – Prohibited Basis

- Creditor shall not inquire about: Race, Sex, Age, National Origin (notwithstanding the required collection of information for monitoring purposes 1002.13)
- Creditor shall not inquire about the applicant’s:
  - Marital status if applying for separate credit (unless in a community property state)
  - Receipt of public assistance or
  - Exercising rights under the Consumer Credit Protection Act
Fair Housing Act

• Title VIII of the Civil Rights Act of 1968 (Fair Housing Act) amended and prohibits discrimination in the sale, rental, and financing of dwellings, and in other housing-related transactions based upon race, color, national origin, religion, sex, familial status and disability.

• Examples of additional protected classes are age, sexual orientation, marital status, occupation, and military status.
  - Loans to buy, build, repair, or improve dwellings
  - Purchase or rental of residential dwellings
Fair Housing Act (cont.)

Prohibited Acts:
• Refuse to rent, sell or negotiate for housing
• Set different terms, conditions, privileges or provide different services
• Refuse to make a mortgage loan or provide homeowners insurance
• Discriminate in appraising property
• Refuse to purchase a loan
• Set different terms or conditions to purchase a loan
Disparate Impact – What?

Disparate Impact

• A lender's policies, even when applied equally to all its credit applicants, may have a negative effect on certain applicants.
• For example, a lender may have a policy of not making single family home loans for less than $60,000.
• This policy might exclude a high number of applicants who have lower income levels or lower home values than the rest of the applicant pool.
• That uneven effect of the policy is called disparate impact.
Illegal disparate treatment occurs when a lender bases its lending decision on one or more of the prohibited discriminatory factors covered by the fair lending laws.

For example, if a lender offers a mortgage with a closing cost of $750 for applicants age 41 through 61 and $1,500 for applicants under the age of 40, this policy violates the ECOA’s prohibition on discrimination based on age.
Unfair, Deceptive or Abusive Acts or Practices

The Act provides the CFPB with rule-making authority to prevent unfair, deceptive, or abusive acts or practices in connection with any transaction with a consumer for a consumer financial product or service.²

CFPB examination objectives are to review internal controls, policies, and procedures to avoid UDAAP. Identify acts or practices which materially increase the risk of consumers being treated in an unfair, deceptive, or abusive manner.
Unfair, Deceptive or Abusive Acts or Practices (cont.)

CFPB has identified several “unfair” mortgage origination acts and practices (appraisal validation, affiliate relationships), mortgage servicing (modifications), and debt collection as having unfair acts and practices identified.

CFPB has identified marketing of add-on products, mortgage origination (interest rate disclosures), mortgage servicing (right to appeal loan modification denial), credit cards (marketing materials) as deceptive.
12/16/16 - CFPB’s fair lending team in 2017 is increasing focus in these areas:

• **Redlining.** We will continue to evaluate whether lenders have intentionally avoided lending in minority neighborhoods.

• **Mortgage and Student Loan Servicing.** We will determine whether some borrowers who are behind on their mortgage or student loan payments may have more difficulty working out a new solution with the servicer because of their race or ethnicity.

• **Small Business Lending.** Congress expressed concern that women-owned and minority-owned businesses may experience discrimination when they apply for credit, and has required the CFPB to take steps to ensure their fair access to credit.
Poll #2

Of the three areas CFPB's fair lending team will be focusing on, you're most concerned about:

* Redlining.
* Mortgage and Servicing.
* Small Business Lending.
Home Mortgage Disclosure Act and Fair Lending

• What will you do with the new data you will be collecting in 2018 as it relates to Fair Lending? These are designed to assist the regulators in making allegations of discrimination more credible, but are they seeing false positives in your data?
• What is your data telling you about your fair lending practices? Get ahead of the regulators!
• What are you doing with your fair lending analysis?
What’s New? – Not Really

Reasonably Expected Market Area (REMA)

Given: Your assessment areas consist of one or more Metropolitan Statistical Areas (MSA)/Metropolitan Division (MD) and one or more contiguous political subdivisions (counties, cities, towns, townships or Indian reservations). Your Assessment Area (AA) consists of whole geographies, does not exclude low- or moderate-income geographies, does not extend substantially beyond an MSA/MD boundary or state boundary unless multistate MSA/MD.
What’s New? – Not Really (cont.)

Reasonably Expected Market Area (REMA)

FFIEC Interagency Fair Lending Examination Procedures:

- REMA - where the institution actually marketed and provided credit and where it could reasonably be expected to have marketed and provided credit!!!
- Some REMAs might be beyond or otherwise different from a bank’s CRA assessment area
- Trade/Market Area – where the bank primarily markets and lends not based on branches, typically larger than CRA AA
Reasonably Expected Market Area (REMA)³

REMA is used to evaluate redlining risk
• The analysis will determine whether a bank is providing equal access to credit in its REMA.
• This will involve looking at whether the bank is:
  o Not extending credit in certain areas
  o Targeting certain areas with less advantageous products
  o Offering different loans to different areas
  o Not marketing residential loans in certain areas
What’s New? – Not Really (cont.)
Fair Lending Analysis

• Use your data to conduct a redlining assessment including REMA!
• Plot your loans on a map
• Use the information you derive from your Fair Lending service provider who most likely slices and dices your HMDA and Community Reinvestment Act data for you.
• Don’t forget to add an analysis of those loans which are not HMDA or CRA reportable (expected by your regulator)!
What Is Not New?

Share your analysis with the most important stakeholders in your organization!

1. Your CRA Committee – they need to see the analysis and the story the analysis tells: potential redlining, marketing, steering, pricing, and see the mapping of loans in the AA.
2. Your Lenders – pricing disparities, document why, do you review pricing exceptions? Are they fairly applied? Is your analysis showing one race is denied more quickly than another race?
3. Your Marketing Department – their areas of emphasis, type of marketing (is it inviting?), where are you marketing within your footprint and what is the overall strategy?
Share your analysis with the most important stakeholders in your organization!

4. Legal – proper internal controls prevent discriminatory practices.
Who Has Responsibility?

Accountability belongs with everyone within the organization. The previous slides were not in order of accountability but those who share the responsibility in your organization.

REMEMBER:
Strong internal controls should include well-documented denials, well-documented loan pricing differentials, prompt correction of self-identified problems, training, communication and continual assessment of risk.
CFPB and Complaints

Examiners will review any lending related complaints or comments about your organization. If there are complaints alleging discrimination (review the CFPB complaint log for your institution or third party providers), you need to document to the fullest extent your root cause analysis, your additional controls, how you addressed the complaint, and how you responded to the complaint.

These feed into the overall evaluation of the fair lending compliance management program and your organization. Your program consists of your policies, procedures, training, monitoring and corrective actions.
Financial Institution Risk Assessment

Risk Factors to consider for inclusion:

• Underwriting
• Appraisals
• Pricing guidelines – specific attention to pricing discretions
• Loan Terms
• Loan Application Forms
• Pre-Approval and Pre-Qualification Programs
• Brokerage agreements / third party agreements and the organization’s control over those agreements
• Compensation
Financial Institution Risk Assessment (cont.)

- Overdraft programs reviewed for fair lending
- Demographics for your AA (should be in your CRA self-assessment so leverage it!)
- Training
- Gap Analysis
- Have a matched pair analysis completed and include in risk assessment
- Include reasonably expected market area assessment / discussion
Summary of conclusions (be honest – your controls in place should determine your risk ratings).

- Quantity of risk: low / moderate / high
- Quality of risk management: strong / satisfactory / insufficient / weak
- Aggregate of risk: low / moderate / high
- Direction is expected to be: decreasing / stable / increasing
Examinations

Get credit for what you do and do well!

a) Fair Lending Risk Assessment
b) Comparative file analysis – remember all types of loans not just CRA and HMDA reportable
c) Document the pricing differences
d) Document your marketing efforts and how you are encouraging applicants in low and moderate income tracts
e) Hold everyone accountable from the moment a borrower comes into your organization – be welcoming, do not steer, take the time to review the applications
Poll #3

What are your top 3 concerns regarding your fair lending risk assessment?

* Overdraft programs reviewed for fair lending
* Demographics for your AA (should be in your CRA self-assessment so leverage it!)
* Training
* Gap Analysis
* Have a matched pair analysis completed and include in risk assessment
* Include reasonably expected market area assessment / discussion
ABA Whitepaper -- Fair Lending - Fighting Illegal Discrimination: Promoting Growth for the Whole Community

“In recent redlining enforcement actions, Agencies have disregarded a bank’s CRA assessment area. Instead they have overlaid their own creation, a ‘reasonably expected market area’ (REMA) or a ‘Proper Assessment Area’— an area Agencies assert that the bank should serve. In other words, Agencies substitute the bank’s judgment about the market area it can serve with their own judgment, informed by a subjective use of statistical analysis. Arguably, the REMA appears designed to justify a preconceived regulatory conclusion of redlining. There has resulted the curious anomaly of banks that received high CRA marks over an extended period of time facing regulatory assertions of redlining.”
“…In some enforcement actions Agencies have been unwilling to consider purchased loans, despite the fact that under CRA banks are encouraged to purchase loans. It has long been recognized that purchasing loans promotes financial access, facilitates a bank’s portfolio diversity, and significantly enhances a bank’s reach into underserved areas and communities, while supporting local loan originators by providing market access for their loans. Regulatory disregard for purchased loans may reduce credit availability and limit local economic growth, particularly in economically stressed areas.”
Fair Lending Presentation

Footnotes:

1. HUD.Gov
2. CFPB Consumer Laws and Regulations UDAAP guide
3. FDIC “Are you at Risk for Redlining?”
4. FFIEC Fair Lending Examination Procedures, August 2009
5. OCC Fair Lending Handbook, January 2010
6. ABA Fair Lending White Paper, April 2017
Questions?
CPE Overview/Requirements

1. 50 minutes in session
2. Three interactive polls
3. Survey feedback
4. CPE certificate access

Certification

CPE questions?
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