Fair Lending An Examiner Take

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Tory Haggerty, CRCM, CAFP, CBAP, CCBCO, FLE

President – Tuscan Club University

Tory Haggerty

Worked in banking for 13 years

Commissioned compliance examiner with FDIC

Participated in over 300 exams and audits

Authored the nation's only Fair Lending School for banking industry

Besting-selling author of *UnFair Lending*

Worked as internal auditor and compliance officer

Retired officer in the South Dakota Air National Guard

Married with 2 kids – Reside in Sioux Falls, South Dakota

UNFAIR LENDING

WHY DISCRIMINATION IN BANKING STILL EXISTS AND HOW TO PREVENT IT

TORY HAGGERTY

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Tuscan Club University

Online Fair Lending School

Authored by Commissioned Examiners

Learn how to build and audit your institutions program

Earn the Fair Lending Expert (FLE) Certification

Find out how examiners conduct a fair lending review

10 Continuing education credit hours

www.tcuniversity.us

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Tuscan Club Consulting

Regulatory audit services

Comprehensive fair lending reviews

Examination prep

HMDA program and data analysis

Residential real estate reviews

Employee training (Group & one-on-one)

Employee transition and branch acquisition

Compliance questions and support

www.tcconsulting.us

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What We Are Going To Talk About

Fair Lending Laws – Prohibitive Basis

Three Types of Discrimination

Regulatory Insight to Fair Lending

Applications

Steering

Underwriting

Pricing

Exceptions

Denials

Redlining

Marketing

Your Role in the Bank

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Poll Question #1

True or False?

It is <u>legal</u> to discriminate against a loan applicant.

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Laws Governing Fair Lending

Equal Credit Opportunity Act (ECOA)

Fair Housing Act (FHA)

Prohibitive Basis

ECOA
- Race
- Color
- Religion
- Sex - UPDATED
- National Origin
- Age
- Marital Status
- Source of Income – Public assistance
- Filing for protection under the Act

FHA
- Race
- Color
- Religion
- Sex
- National Origin
- Familial Status
- Handicap

Other Laws Connected To Fair Lending

Home Mortgage Disclosure Act (HMDA)

Community Reinvestment Act (CRA)

HMDA
- Collect data on home loan applicants
- Aggregate data analysis
- Redlining risk issues
- Steering risk
- Pricing risk

~~CRA~~
- ~~Redlining~~
- ~~Lending to all parts of assessment area~~
- ~~Lending to all income levels~~
- ~~CRA findings are public~~

Types of Discrimination

Overt Discrimination
When a lender openly and blatantly discriminates on a prohibitive basis

Disparate Treatment
Occurs when a lender treats an applicant differently based on one or more prohibitive basis

Disparate Impact
A policy or practice that may be applied equally to all credit applicants, but the policy or practice has a disproportionate adverse impact on applicants from a group protected against discrimination

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Regulatory Insight

Examiners conduct a fair lending review at every compliance examination (whether you know it or not)

Typical fair lending reviews include:
- ❏ Loan Policy
- ❏ Underwriting guidelines
- ❏ Pricing practices and rate sheets
- ❏ Exceptions
- ❏ Loan committee minutes
- ❏ Loan download

REVIEW

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Regulatory Insight

All reviews are risk focused

Areas covered could be:
- Pricing
- Underwriting
- Comparative file analysis
- Redlining
- Steering

Fair lending interview - What is the purpose?

Loan Lifecycle of Risks

What is an Application?

Application means an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested.

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Taking Applications

LOAN LIFECYCLE

Internally developed applications vs. industry standard

Discouraging applications
- Loan Officer
- Teller
- Administrative assistant

Car loan example – FDIC complaint

Process must be consistent
- Going the "extra mile" for some applicants but not others

Treat everyone the same way every time

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Steering

LOAN LIFECYCLE

Steering – The distinction between guiding consumers toward a specific product or feature; **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.

Steering Indicators:

Lack of clear, objective and consistently implemented standards for referring applicants

Financial incentives for loan officers or brokers to place applicants in nontraditional products

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

Significant differences in the percentage of prohibited basis applicants in loan products or products with specific features relative to control group applicants

Consumer complaints

Poll Question #2

Which of these situations has the highest risk for illegal steering?

a. Selling credit life insurance

b. Offering government guaranteed home loans

c. Having car dealer referral relationships

d. Each of these risks are dependent on the overall situation

Underwriting

LOAN LIFECYCLE

Major Risk Factors:

Unclear underwriting standards

Loan officer deviations

Not tracking deviations

Ineffective or non-existent monitoring

Risk Mitigation:

Clearly written and understood underwriting standards

Deviations to policy are the "exception" not the "norm"

Secondary underwriting reviews
Part of your CMS monitoring

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Pricing

LOAN LIFECYCLE

One of the greatest risks and easiest to track

Rate sheet – not only having one but using it

Consistency

Exceptions – Are you tracking AND what are you doing with the info? – more on that in a moment

Discretion should be controlled and monitored

Examples:

Across-the-board Consumer Pricing

Wild West Consumer Pricing

LOAN PRICING

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Exceptions

LOAN LIFECYCLE

Are loan officers allowed to make exceptions?

Underwriting, pricing, fees, and loan terms?

Are deviations from policy built into your program?

Do they require secondary approval?

Are you tracking exceptions?

If so, what are you doing with them
- Common response

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Denials

LOAN LIFECYCLE

Consistent underwriting helps mitigate risk

Denial reasons – Be accurate

Comparative File Analysis

Adverse action notices

Secondary reviews
- Must be done on a fair basis

Consistency!
- Be careful if you go the extra mile for one customer and not another

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Marketing

LOAN LIFECYCLE

This is where fair lending starts

What message are you sending to your customers?

Market to all areas & all customers – Redlining

Ads should be inclusive of population

Social Media – what is acceptable to post at your institution?

Can you be held accountable for what you post? 2 recent examples

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Poll Question #3

Which of these is a way to reduce fair lending marketing risk?

a. Have a social media policy

b. Have trained compliance staff perform secondary reviews of marketing materials

c. Avoid targeted marketing campaigns to prohibited basis groups

d. All are examples of ways to reduce fair lending marketing risk

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Redlining

LOAN LIFECYCLE

Redlining - 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.

What does that mean?

- 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

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Redlining Examples

Midwest BankCentre

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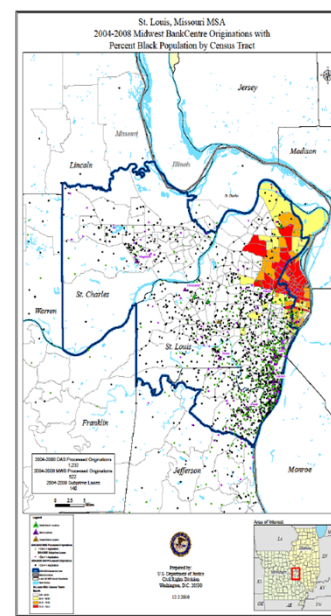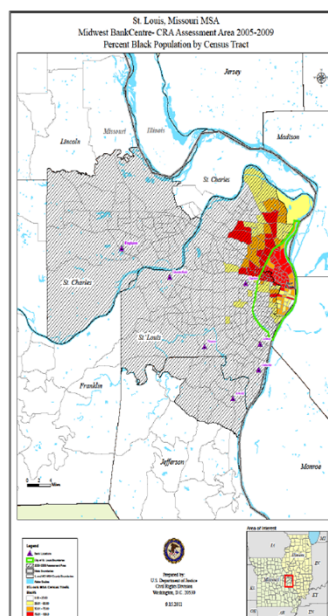
Midwest BankCentre

By the Numbers

Lending in minority census tracts

2004
- MBC – 1.7% of loans; peers – 6.5% = **Ratio 3.8 / 1**

2005
- MBC – 1.4% of loans; peers – 7.8% = **Ratio 5.5 / 1**

2006
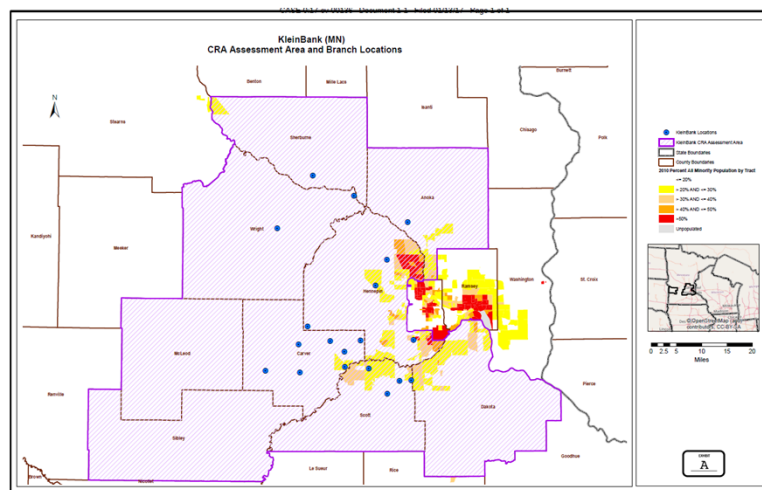- MBC – 4.9% of loans; peers – 8.9% = **Ratio 1.8 / 1**

Applications in minority census tracts 2004 – 2008
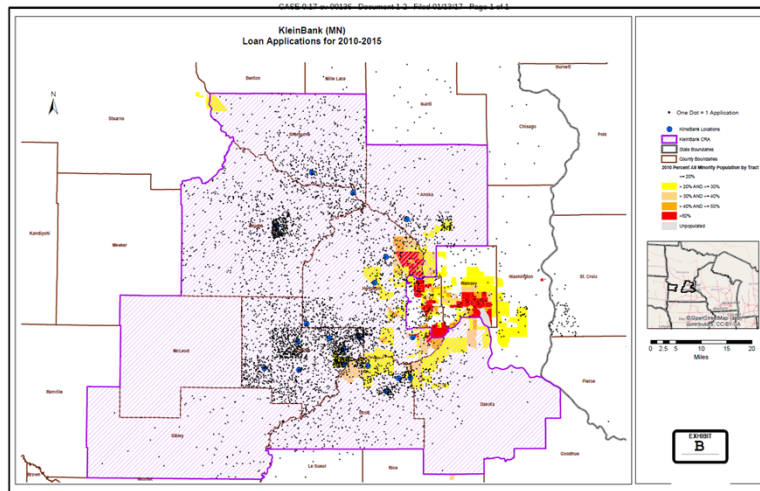- MBC – 2.7% of apps; peers – 10.7% = **Ratio 4 / 1**

Redlining Examples

KleinBank

Redlining Examples

KleinBank

KleinBank

By the Numbers

Lending in minority census tracts

2010 – 2015

- KleinBank – 1.2% of loans; peers – 5.2% = **Ratio 4.3 / 1**

Applications in minority census tracts

- KleinBank – 1.0% of apps; peers – 5.6% = **Ratio 5.6 / 1**

The Classics

Having spouses sign the note when they didn't apply

Documenting joint intent – signing the bottom of the application or submitting a joint financial statement is not good enough

Requiring specific cosigners – you can require a cosigner, but you cannot state who it has to be

Charging different credit report fee amounts for single and married couples

Not grossing up non-taxable income

Poll Question #4

Who is the greatest Major League Baseball pitcher of all time?

a. Sandy Koufax

b. Walter Johnson

c. Nolan Ryan

d. Cy Young

e. There is no right answer; this is an unfair opinionated question and I don't want to play anymore

Lender's Responsibility

➢Always use bank approved applications

➢Don't go the extra mile for one applicant and not another

➢Follow bank underwriting and pricing guidelines

➢Get proper approval for any deviations from policy

➢Understand the prohibitive basis

➢Understand your role in mitigating the fair lending risk to your institution

➢Follow your institutions social media guidelines and be responsible

My role is _____.

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Questions

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