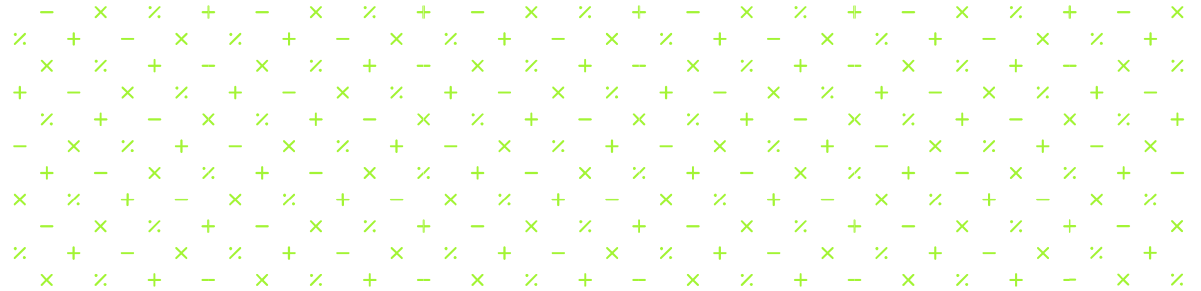


# Fair Lending – Regulations, Risk, Measurement, and Assessment

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Carroll Gilker, CRCM, CAMS

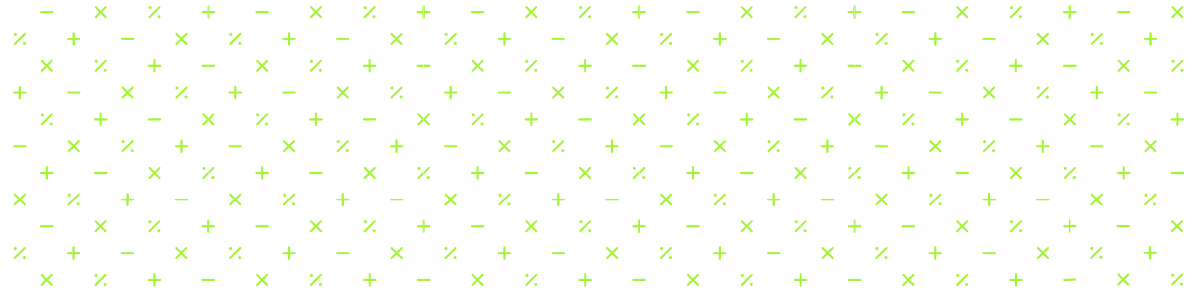
Noory Song, CRCM, CAMS, CRMA



# Equal Credit Opportunity Act (ECOA)

The ECOA prohibits discrimination based on:

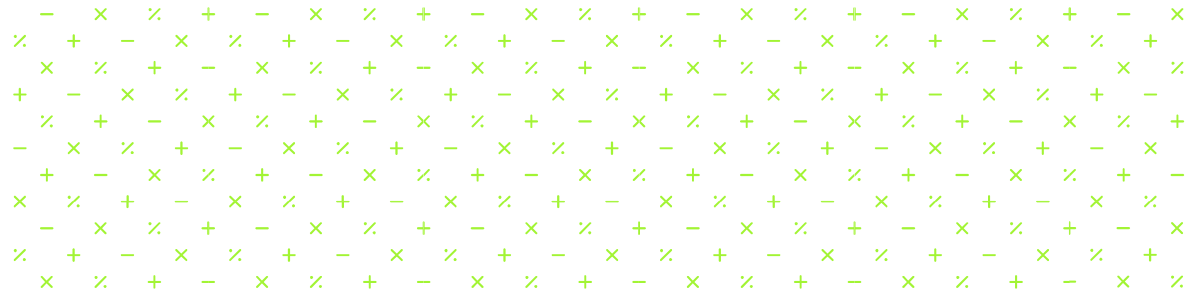
- Race or Color
- Religion
- National Origin
- Sex
- Marital Status
- Age (provided the applicant has the capacity to contract)
- The Applicant's receipt of income derived from any public assistance program
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act



# Fair Housing Act (FHAct)

FHAct prohibits discrimination in all aspects of “residential real-estate transactions” including:

- Race or Color
- National Origin
- Religion
- Sex
- Familia 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)
- Handicap.

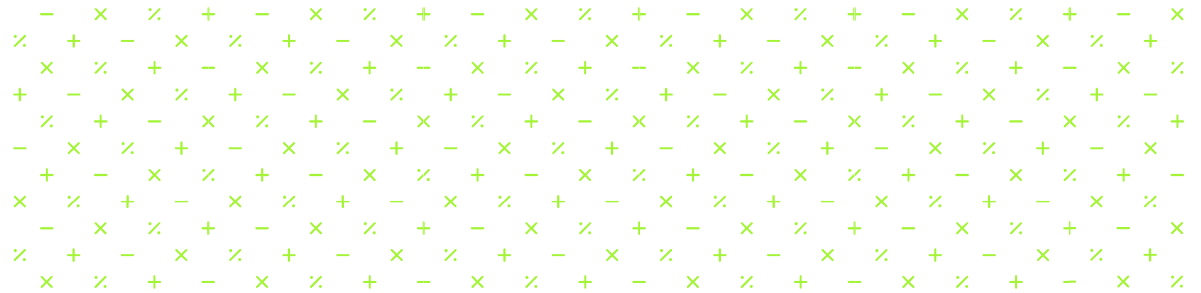


# Types of Lending Discrimination

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

**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** – There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis. There is overt evidence of discrimination even when a lender expresses – but does not act on – a discriminatory preference.

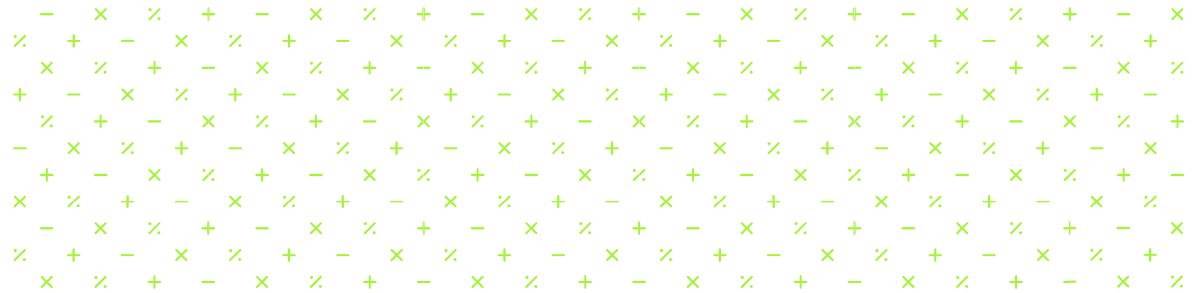


**Comparative Evidence of Disparate Treatment** – Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited basis. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person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

If an applicant’s application is a “close case” there is more room and need for lender discretion. Also, whether or not an applicant qualifies may depend on the level of assistance the lender provides the applicant in competing an application.

**Disparate Impact** – When a lender applies a racially or otherwise neutral policy or practices equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practices is described as have a “disparate impact.”

When it is discovered that a lender’s policy or practice has disparate impact; it must be determined whether the policy or practice is justified by “business necessity.”



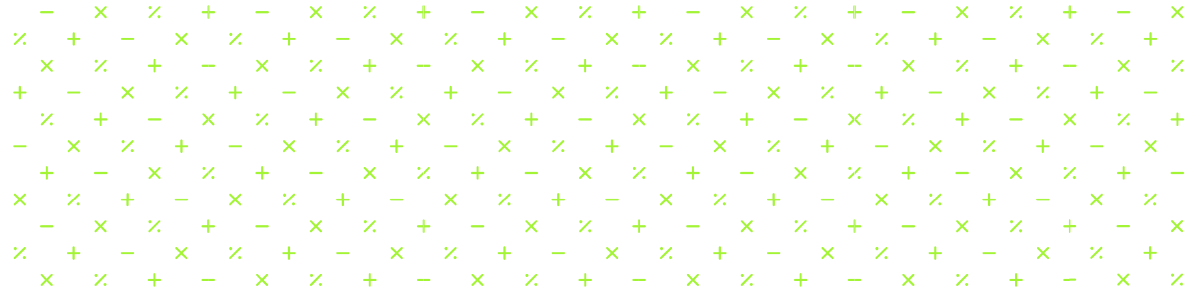
# Community Reinvestment Act (CRA)

Requires Financial Institutions to define their lending assessment area(s) and analyze where their loans are located within the assessment area(s) by census tract.

FFIEC Census Tracts have income levels which include:

- High
- Median
- Moderate
- Low

Census Tracts also have racial break downs including percentages of: Minority - Non Minority and percentages of racial and ethnic groups such as Non Hispanic White, American Indian, Asian, Black and Hispanic.

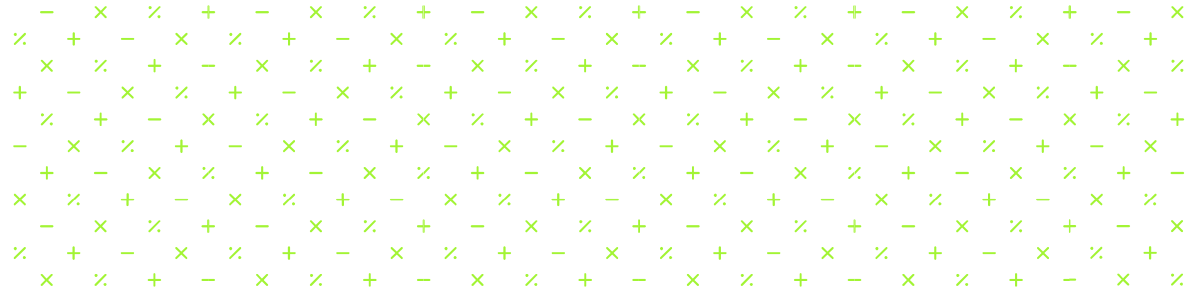


# Home Mortgage Disclosure Act (HMDA)

Requires Financial Institutions that provide residential mortgage loans to collect personal information on their applicants including their gender, race and ethnicity, income, location of the residential property and whether the loan was approved or not.

2018 HMDA will have Expanded Data Collection that include:

- Retains 9 data elements
- Modifies 14 data elements
- Adds 25 new data elements including credit scores, debt to income, loan to value, cost of loan
- Total of 48 data elements, with 110 data fields



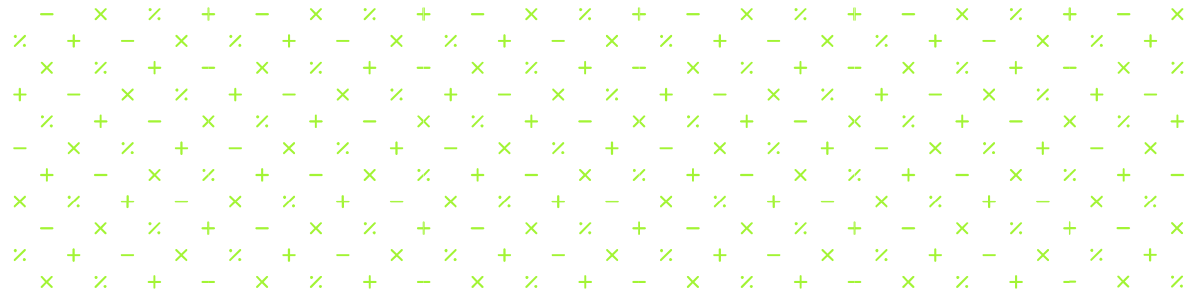
# Truth in Lending Act (TILA)

Requires Financial Institutions to provide the cost of a consumer loan by disclosing the finance charge and the Annual Percentage Rate (APR)

**Section 32 high cost mortgages** – Covers certain mortgage transactions that involve the borrower’s primary residence. It applies when the APR is over the (Average Prime Rate Offer + 6.5% first lien and 8.5% subordinate liens) and when ever the mortgage prepaid finance charge exceeds 5% of the total loan amount, whichever is higher.

**Section 35 higher priced mortgage loans (HPML)** – Covers certain mortgage transactions secured by the consumer’s principal dwelling with APR that exceeds the APOR by 1.5% for first lien loans, 2.5 jumbo loans and 3.5% for subordinate liens.





**Ability to Repay Rule** – The rule requires most mortgage lenders to make a reasonable and good faith determination that applicants are able to pay back the loan. Under the rule, lenders must generally find out, consider, and document a borrower’s income, assets, employment, credit history and monthly expenses.

If a mortgage has a low interest rate that goes up in later years, the lender has to make a reasonable effort to figure out if the borrower can pay the higher interest rate too.

# Polling Question #1

Which of the following categories is not protected under the Equal Credit Opportunity Act?

- A. Religion
- B. Race or Color
- C. Low Income Level
- D. Sex



# Risk Areas – Marketing

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- Message contains prohibitive or discouraging language
- Images do not represent the make up of the community
- Types of media
- Geography limited to certain ethnic areas



# Risk Areas – Underwriting and Decline Decisions

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- Automated decision
- Manual decision
- Documentation and monitoring denial process
- Second review process



# Risk Areas – Pricing

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- Criteria for higher or lower rates
- Fees applied and waived
- Floor and ceiling rates
- Documentation and monitoring processes



# Risk Areas – Credit Policies and Procedures

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- Prohibited basis
- Review processes
- Consistency and exceptions



# Risk Areas – Customer Service

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Ability to waive or change



# Risk Areas – Collections/Recoveries

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- Managed internally or outsourced
- Fair and objective guidelines
- Hardship program





# Risk Areas – Loss Mitigation and Foreclosures

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- Managed internally or outsourced
- Workout package (loan modification, debt forgiveness, short sale, deed in lieu of foreclosure)
- Documentation and monitoring



# Risk Areas – Incentive Programs

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- Incentives for acquiring new clients
- Product selection and steering



# Risk Areas – Fair Lending Training

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- Who receives fair lending training
- Computer general awareness
- In-depth classroom training
- Initial, on-going and targeted
- How often offered



# Risk Areas – Quality Assurance

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- Monitoring (e.g., call monitoring, mystery shopping, management review of loan documentation, statistical analysis, side-by-side testing)
- How often
- Governance
- Response and remediation to issues



# Risk Areas – Complaints

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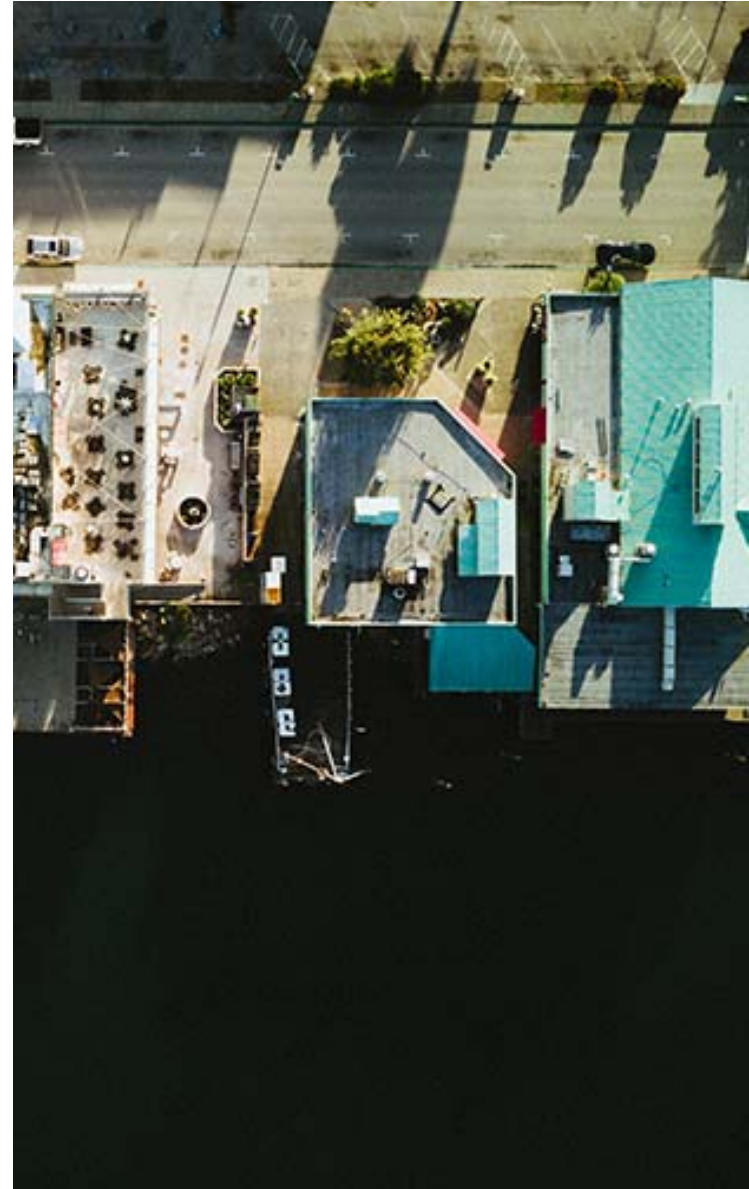
- Monitor customer complaints related to fair lending
- Monitor regulatory complaints related to fair lending
- Investigation and resolution



# Risk Area – Redlining

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- Targeted market area
- Census tract racial profiles
- Placement of branches
- Analysis of loan locations



## Polling Question #2

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What risk area is important to a financial institution for providing information to staff about the various forms of discrimination and how they could be prevented?

- A. Quality Assurance
- B. Pricing
- C. Training
- D. Incentive Programs



# Measures – Groups

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- **Race – American Indian/Alaska Natives, Native Hawaiian/Other Pacific Islanders, Asian, White, Black/African American**
- **Ethnicity – Hispanic**
- **Sex**
- **Segregated Geographies**





# Measures – Source of Group Identification

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- HMDA Government Monitoring Information
- Gender First Names
- Self- Testing
- Using census geography and surname data to construct proxies for race and ethnicity
- Financial Institution's core data system



# Measures – Marketing

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Review the financial institutions marketing materials and check for:

- Language that a reasonable person would believe to indicate prohibited basis customers are less desirable
- Images that do not include all racial, ethnic or gender groups that make up the institution's communities
- Advertising only in media serving non-minority areas of the market
- Using mailing or other marketing techniques of residential loan products that explicitly exclude groups of prospective borrowers on a prohibited basis



# Measures – Underwriting and Decline Decision Comparisons: Side by Side Testing

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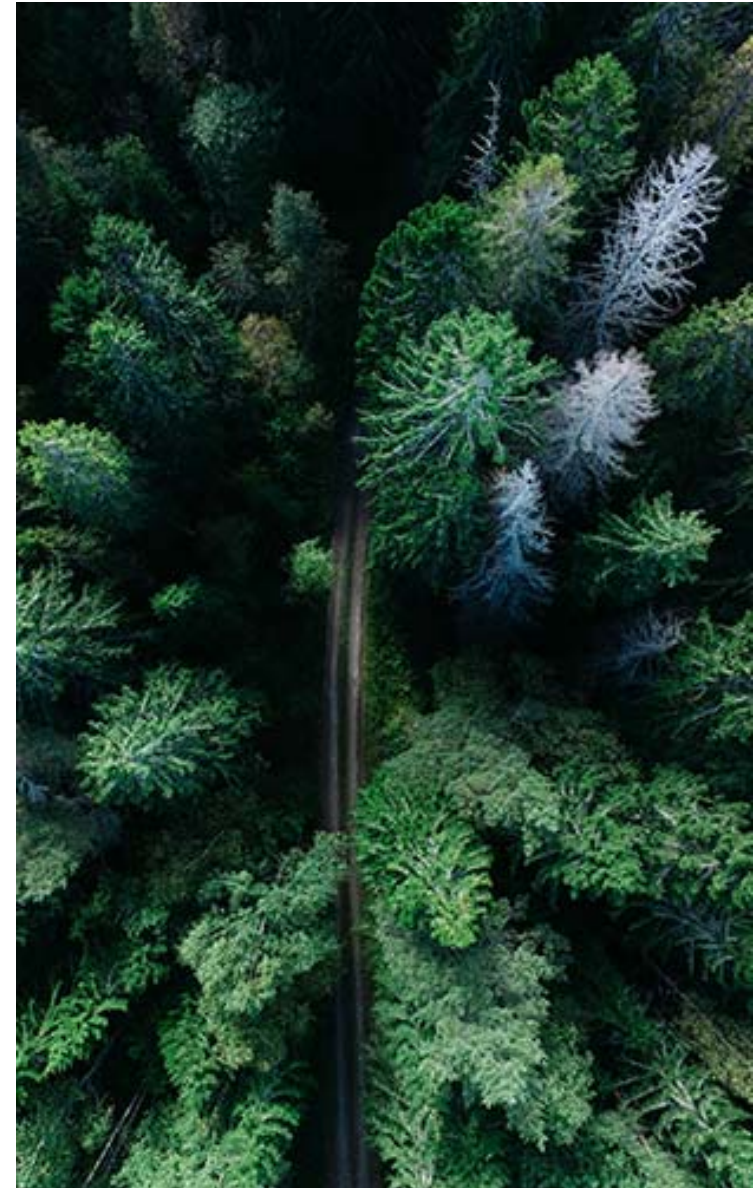
- Review the Bank's underwriting guidelines to ascertain decision points
- Select Loan Type: Mortgage, Auto, etc.
- Select Target Group (Declined Applications) and Control Group (Approved Applications)
- Sort by and match by decision attributes, i.e. credit score, DTI, LTV, collateral attributes (e.g. new v. used car, etc.)
- Conduct Regression Analysis to identify possible disparate impact discrimination



# Measures - Pricing

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- Focal Points – Product Type, Group Type
- Applicable Pricing Policies
- Sort by Pricing –Highest to Lowest
- Sort by Group Types
- Regression Analysis of loans with high prices and identify possible patterns of discrimination or disparate impact



# Measures – Loan Officer Compensation

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- Loan Officer are not compensated based on the amounts of fees and charges or the number of high or higher priced loans originated
- Policies, procedures or practices do not indicate “steering” loan applicants to higher priced loan products
- Review the financial institution’s compensation practices.



# Measure – Exceptions

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Review the Bank's loan exceptions and determine any patterns of prohibited basis customers not being included in the decisions.

If applicable determine from management why prohibited basis customers, i.e. minorities or women are not provided with exceptions.



# Measures – Redlining Geographies

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- From the Financial Institution's market area or CRA Assessment Area determine by using the FFIEC Geocoding System the ratio of census tracts that are primarily minority (i.e. over 50%) compared to primarily non-minority.
- Select a popular loan product and from the portfolio of originated loans determine the number of census tracts that are primarily minority populated v non-minority populated census tracts. Compare the ratios.



# Polling Question #3

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When measuring for fair lending what type of discrimination are you try to identify?

- A. Income levels
- B. Strength of collateral
- C. Prohibited basis customers
- D. Identity theft victims





# Fair Lending Risk Assessment – Key Components

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1. Identify all areas where inherent risk is possible (e.g., Marketing Department, Lending Department, Customer Services, etc.) and identify key risk factors
2. Applicability/Amount/Impact (i.e., volume of transactions, severity of possible adverse impact, how many related complaints did you receive, results of HMDA data analysis)
3. Identify all mitigating controls you have in place such as written policies and procedures, board management reports, training records, compliance monitoring, external audits, etc.
4. Document your concluded risk rating for each of the key risks once mitigating controls have been considered (e.g., high, medium, or low)



# Fair Lending Risk Assessment – Key Components (continued)

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1. Fair Lending History (Prior Findings, Complaints, HMDA)
2. Management (Board of Directors/Supervisory Committee, Policies and Procedures, Monitoring , Training, Compensation)
3. Lending Practices (Product Offering, Delivery Channels, Demographics, Pricing, Underwriting, Exceptions)
4. Lending Support Services (Advertising, Loss Mitigation)



# Fair Lending Risk Assessment Sample

Number	Category	Qualitative Risk Factors	Frequency	Significance	Inherent Risk	Mitigating Controls	Control Value	Residual Risk
1	Prior Findings	The Credit Union has had prior audit and regulatory fair lending findings and no follow-up was conducted.	X	X	X	The Credit Union has established processes to address and correct prior findings. Updated controls will mitigate weaknesses to prevent repeat occurrences.	X	X
2	Complaints	The Credit Union does not have a customer complaint program; complaints actually indicate that the lender restricts access to credit in high minority areas.	X	X	X	The Credit Union has established processes to respond to and, if applicable, correct any complaint associated with fair lending. If actual discrimination is identified, the Credit Union will correct with appropriate actions.	X	X
3	HMDA	The Credit Union's HMDA LAR indicates possible discriminatory results on a prohibited basis.	X	X	X	The Credit Union's lending policies and procedures prohibit discriminatory behavior and promote originations for all qualified applicants.	X	X



# Fair Lending Risk Assessment Sample (continued)

Number	Category	Qualitative Risk Factors	Frequency	Significance	Inherent Risk	Mitigating Controls	Control Value	Residual Risk
4	Board of Directors	The Board of Directors has not approved a Fair Lending Policy. The Board is not kept informed on the status of the Credit Union's Fair Lending Program.	X	X	X	The Board of Directors has approved a Fair Lending Policy and is kept informed on the status of the program.	X	X
5	Policies and Procedures	Policies and procedures contain overtly discriminatory statements and subjective language; they are not clear and objective.	X	X	X	The Credit Union's lending-related policies and procedures are reviewed on an annual basis to ensure they do not contain statements that could be considered discriminatory.	X	X
6	Monitoring	The Credit Union does not monitor ongoing fair lending compliance risk exposure; there is no second review process for declined loans; the Credit Union does not make any comparative analysis for pricing rates between prohibited basis groups; or the Credit Union does not analyze approval rates and denial rates.	X	X	X	The Credit Union monitors declined loans with periodic second reviews. Exception reports are reviewed by the Board of Directors on a monthly basis.	X	X
7	Fair Lending Training	The Credit Union does not have fair lending training or the training is not effective; fair lending training is restricted to lending staff; or there is no tracking of fair lending training for attendance or completion.	X	X	X	The Credit Union provides fair lending training through X, which includes lending compliance courses for all staff members responsible for lending activity.	X	X
8	Compensation	The Credit Union has established compensation packages base on loan volume and/or pricing.	X	X	X	The CU provides bonuses for branch and lending staff based on volume.	X	X



# Polling Question #4

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How much do you appreciate the ACUIA for putting this together?

A. I love the ACUIA!

B. The ACUIA is just ok.

C. I am never attending an ACUIA event again.



# Contact Information

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38

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