Fair Lending
Compliance Basics:
Class is in Session!

How to Control Fair Lending Risk
and Identify Redlining Risk

Meet Your Teacher

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Kimberly Boatwright, CRCM, CAMS, joined TRUPOINT Partners in 2014 as the Director of
Compliance. Ms. Boatwright has more than a two decades of experience working in the
financial services industry and in risk management.

Prior to working with TRUPOINT, Ms. Boatwright was the Vice President - BSA/AML and
Compliance Officer for the corporate compliance division of Rabo Agrifinance. She was
responsible for implementing all aspects of the AML and regulatory compliance
programs.
What We’ll Cover Today

• Today’s Fair Lending Landscape
• Key Fair Lending Risks & How to Control Them
• Essentials of a Strong Fair Lending Compliance Management System
• Redlining Compliance Risks

Today’s Fair Lending Landscape
Fair Lending Today

Fair Lending compliance can be tough.

Why? It’s a regulatory focal point, the risks are high, guidance isn’t always clear & the requirements can be overwhelming.

A common priority among regulators in 2017 is Redlining. Do you know how you compare? Are you analyzing your data?

Later, we will discuss how data analysis can help you prepare.

Regulators are Focusing On...

- **CFPB**
  - Redlining
  - Student Loans
  - Mortgage Servicing

- **FDIC**
  - Redlining
  - REMAs

- **OCC & Federal Reserve**
  - Redlining
Nationstar Mortgage

- The Consumer Financial Protection Bureau (CFPB) took action against Nationstar Mortgage LLC for violating the Home Mortgage Disclosure Act (HMDA).
- The CFPB alleged that Nationstar consistently failed to report accurate data about mortgage transactions for 2012 through 2014.
- The CFPB is requiring Nationstar to:
  - Pay a $1.75 million civil penalty,
  - Improve its compliance management to prevent future violations, and

Chase

- The CFPB took action against JPMorgan Chase Bank, N.A. for failures related to information it provides for checking account screening reports.
  - Banks screen potential customers based on reports about prior checking account behavior created by consumer reporting companies.
  - Banks that supply information for those reports are legally required to have proper processes in place for reporting accurate information.
  - Chase did not have these processes in place and kept consumers in the dark about the results of their reporting disputes and key aspects of their checking account application denials.
- The Bureau is ordering Chase to:
  - Pay a $4.6 million penalty, and
  - Implement necessary changes to its policies to prevent future legal violations.
Aequitas Capital Mgmt.

- The CFPB filed a complaint and proposed settlement against Aequitas Capital Management, Inc. and related entities.
- Allegations including:
  - Aiding the Corinthian Colleges’ predatory lending scheme.
  - Enabling Corinthian to make high-cost private loans to students, so that it would seem as if the school was making enough outside revenue to meet the requirements for receiving federal student aid dollars.
- The risky loans saddled students with high-priced debt that both Aequitas and Corinthian knew students could not afford.
- Under the CFPB’s proposed settlement, if approved, about 41,000 Corinthian students could be eligible for approximately $183.3 million in loan forgiveness and reduction.
- In collaboration with the CFPB, several state attorneys general have also reached proposed settlements with Aequitas.

Ocwen Financial Corp.

- The CFPB sued Ocwen, one of the country’s largest nonbank mortgage loan servicers, and its subsidiaries.
- Allegations include:
  - Failing borrowers at every stage of the mortgage servicing process.
  - Years of widespread errors, shortcuts, and runarounds cost some borrowers money and others their homes.
  - Botched basic functions like sending accurate monthly statements, properly crediting payments, and handling taxes and insurance.
  - Illegal foreclosures on struggling borrowers, ignored customer complaints, and sold off the servicing rights to loans without fully disclosing the mistakes it made in borrowers’ records.
- The Florida Attorney General took a similar action against Ocwen in a separate lawsuit. Many state financial regulators are also independently issuing cease-and-desist and license revocation orders against Ocwen for escrow management and licensing issues today.
**Bancorp South**

• Brought by the CFPB and DOJ.
• Complaint allegations:
  – Illegal Redlining in Memphis.
  – Denying certain African-American mortgage loans more often than similarly situated control group applicants.
  – Charging African-American customers more for certain mortgage loans than similarly situated control group borrowers.
  – Having an explicitly discriminatory loan denial policy.
• Note: This is one of the first consent orders where the CFPB openly admitted to using mystery shoppers to investigate.

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**Key Fair Lending Risks**
Key Risks to Analyze

• There is Fair Lending risk at every stage of the crediting process, and you should conduct data analysis during each. Those include:
  – Redlining Risk
    • REMAs
  – Marketing Risk
  – Steering Risk
  – Underwriting Risk
  – Pricing Risk
  – Servicing & Loss Mitigation Risk

Note: We will focus on Redlining risk.

It’s a regulatory priority, so it’s worth spending a little extra time on it. In fact, it’s the focus of every regulator this year!
Redlining is “provid[ing] 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.”

- 2009 Interagency Fair Lending Examination Procedures

Key Redlining Risk Factors

In addition to analyzing your data for disparities that may indicate Redlining risk, examiners will likely review the following risk factors for evidence of Redlining:

- Your REMA
- CRA Assessment Area
- Branch Network, including locations, hours, and ATMs
- Marketing and Outreach
- Overt Statements of Discrimination
- Complaints
- Previous Findings

Make sure to also consider your programs, policies and procedures, and how they can limit Redlining risk.
1. Redlining Risk

Fair Lending compliance prohibits discriminating against individuals based on their geographic location (i.e. in low-income or high-minority areas).

When you analyze your data, you’re looking to answer the following key question:

*Are census tracts in my market area being underserved?*

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1. Redlining Risk (cont’d)

The Redlining dashboard analyzes lending geographically to determine if low-income or high-minority areas are being avoided or underserved.
All about REMAs

REMA = Reasonably Expected Market Area

• A REMA is where the institution actually marketed and provided credit, and where it could be reasonably expected to have marketed and provided credit.
• Some REMAs may be beyond or different from a CRA assessment area.

All about REMAs (cont’d)

Regulators will determine your REMA through:
• Discussions with the bank;
• Considering the branch network;
• Evaluating marketing efforts, including print advertising, calling program(s), and direct mailing(s);
• Reviewing the location(s) or area(s) served by brokers or realtors;
• Assessing the locations of the bank’s loan applications and originations, and deposit customers; and
• Considering significant barriers to lending, such as geographic barriers, limited housing stock, and low population levels.
All about REMAs (cont’d)

REMAs are important to assessing Redlining risk.

Redlining analysis will determine if the bank is providing equal access to credit throughout its REMA by considering:

- If the bank is extending credit selectively.
- If the bank is targeting certain areas with less advantageous products.
- If the bank is offering different loans or products to different areas.
- If the bank is not marketing residential loans to certain areas.

2. Marketing Risk

Fair Lending compliance requires that you reach out to your entire market.

When you analyze your data, you’re looking to answer the following key question:

*Are you receiving the bulk of your applications within your market demographics and lending footprint?*
2. Marketing Risk (cont’d)

The Marketing dashboard analyzes application flow from a Fair Lending perspective.

3. Steering Risk

Fair Lending compliance requires that financial institutions not disproportionately steer protected class/prohibited basis group individuals to certain products.

When you analyze your data, you’re looking to answer the following key question:

*Are we directing certain applicants to certain products?*
3. Steering Risk (cont’d)

The Steering dashboard analyzes application rates by loan type and compares all applicants to determine if protected class individuals are being steered to certain products.

4. Underwriting Risk

Fair Lending compliance requires that loans be approved or denied equally to similarly situated individuals.

When you analyze your data, you’re looking to answer the following key question:

How many protected class loans were originated? How many were denied? How does that compare to control group applicants?
4. Underwriting Risk (cont’d)

The Underwriting dashboard analyzes origination and denials to determine if loan rates are being approved and denied equally to applicants.

5. Pricing Risk

Fair Lending compliance requires that all similarly situated individuals receive similar pricing for similar products.

When you analyze your data, you’re looking to answer the following key question:

*Are all applicants receiving consistent pricing?*
5. Pricing Risk (cont’d)

The Pricing dashboard analyzes Rate Spread and, if provided, APR for both control and prohibited basis groups.

6. Servicing Risk

Fair Lending compliance requires that similarly situated individuals be treated similarly throughout the duration of the loan – even during servicing. This is also one stage of the relationship where consumer complaints are most common.

When you analyze your data, you’re looking to answer the following key question:

*Are we treating similarly situated individuals similarly during servicing?*
6. Servicing Risk (cont’d)

Below are some of the key considerations for evaluating servicing risk, when considered by loan officer:

- Call timing
- Wait times
- Fee waivers
- Payment skipping
- Loss mitigation practices
- Product offerings
- Servicing policies

Servicing policies, including exception policies, will play an essential role in mitigating servicing risk.

In addition, please note that the examiners will consider the Fair Lending risks inherent in any third party vendor or partners’ policies, procedures and programs as your risk.

Fair Lending applies to all types of consumer loans – not just HMDA or mortgage loans.

If you make small business, auto, agricultural or farm loans, or offer other extensions of credit to consumers, make sure that you’re analyzing your data for Fair Lending compliance.
Fair Lending Compliance Management Basics

Every institution – regardless of size – needs to have a strong Fair Lending compliance management system (CMS).

It will help:
• Manage and reduce risk.
• Ensure that policies and procedures are functioning.
• Maintain compliance with key requirements.
9 Keys for a Strong Fair Lending CMS

A Fair Lending Compliance Management Program should include:
1. Board & Management Oversight
2. Annual Risk Assessment
3. Policies and Procedures
4. Annual Role Specific Training
5. Independent Review or Audit
6. Internal Monitoring, testing and reporting
7. Analysis & Reporting
8. Consumer Compliant Management
9. Third-Party Vendor Risk Management

1. Management Oversight

The Board and senior management are essential to effective compliance risk management. They need to be involved in managing Fair Lending.
Why? Their involvement strengthens your culture of compliance with a strong “tone from the top.”

Remember: leadership is held accountable for violations, if and when they arise.
2. Risk Assessment

Best practices recommend that you complete a Fair Lending risk assessment every 12 months, or sooner if your products, services or branch network change.

“Risk assessments are the foundation of an effective compliance monitoring and testing program. The scope and frequency of compliance monitoring and testing activities should be a function of a comprehensive assessment of the overall compliance risk associated with a particular business activity.”

- Board of Governors, FRS

3. Policies & Procedures

Some institutions don’t have a written Fair Lending policy. All institutions need one.

An effective Fair Lending policy is:

• Clear
• Comprehensive
• Covers all products and services
• Includes all phases of operation
• Outlines what you do
• Details what you won’t do

Note: Exceptions to policies and procedures can create risk exposure, so explain, document and report any exceptions to management and monitor for risk exposure.
Keep an eye out for disparities in your data and discretion in your process.

Both of these can present the potential for discrimination (even unintentionally), and are often indicators of Fair Lending risk.

4. Annual Training

Training plays a critical role in Fair Lending compliance. All employees, management and the Board should get training. Not only is it required, it may also improve your culture. To evaluate your training, ask yourself the following:

- Do you offer general training for all employees?
- Do you offer role-specific training for employees directly involved in the crediting process and management?
- Do you offer training annually for all employees, and within a set time period for new hires?
- Does your training explain why Fair Lending matters? For example, violations, personal liability, etc.?
- Do you track attendance, completion and comprehension?
- Are there repercussions for failing to attend, complete or pass training?
- Does your training outline what is permitted by your institution’s policies?
- Do you offer training aids, and are the adequate?
- Does your training explain what to do if an issue arises?
How often do you conduct annual training? Board training? Role-specific training?

5. Independent Review

An independent review or audit evaluates the effectiveness of a compliance program. It will provide a review of your performance and risk profile.

It should be conducted by an independent party, whether external or internal.

How is it different from a risk assessment?

A risk assessment evaluates your risk and establishes a risk profile to help develop a strong compliance program. It’s a snapshot and should be conducted annually.

An independent review or audit focuses specifically on how well your program is managing your risk.
Do you conduct annual reviews or audits of your Fair Lending program?

6. Internal Monitoring, Testing & Reporting

Monitoring ensures that your practices map to your policies. Monitoring may involve reviewing policies, evaluating exceptions and how they relate to policies, and data analysis.

Without monitoring, undetected risks can grow and even lead to repeat offenses. It’s important that the results be reported to management.

The CFPB has said that deficient monitoring is one of the most common weaknesses they see in exams.
7. Analysis & Reporting

Fair Lending analysis and reporting is essential for Fair Lending compliance. It helps determine if similarly situated individuals are treated similarly. Examiners will view disparities as red flags for potential discrimination.

As outlined earlier, here are some key areas to analyze:

- Redlining
- Marketing
- Steering
- Underwriting
- Pricing
- Servicing

Disparity does not always mean discrimination is occurring, but data analysis is the only way to know!

Data analysis is essential to understanding your Fair Lending risk.

When the examiners review your institution, they’ll start with data analysis. Why? Because if you have risk, it’ll show up in your numbers.

When you analyze your data, look for disparities that may indicate potential discrimination, and which will attract regulatory attention.
Fair Lending Data Analysis

So you know you need to analyze your data. But how? What should you look for?

How to analyze your data:
• With a software solution
• With in-house statisticians
• With Excel and pivot tables (rarely adequate)

What to look for:
• Disparities that may indicate discrimination
• Outliers when compared to peers, competitors and national averages

Data to analyze:
• HMDA
• Non-HMDA (Consumer, Commercial, Agricultural, Auto)

Methodology

When analyzing non-HMDA loan and deposit data, the identification of prohibited basis individuals can be determined using one of two methodologies: BISG or Federal Reserve.

BISG
• Stands for “Bayesian-Improved Surname Geocoding”
• Combines geography- and surname-based information into a single proxy probability for race and ethnicity.
• Used by the CFPB and occasionally the FDIC

Federal Reserve (Traditional Proxy Methodology)
• Also used by the FDIC, OCC, HUD
8. Complaint Management

Complaints are a valuable source of information that you can use to understand your reputation and improve program deliver and service.

Your complaint management program needs:
• A strong complaint management policy.
• Complaint management processes and procedures.
• Training.
• Tracking, trending, and reporting.

Focus on complaints that allege discrimination throughout the lending process, either submitted directly to you or third parties like the CFPB or social media.

9. Third Party Management

Financial institutions are responsible for managing third-party relationships, and are liable for the risk involved.

Third-party risk management should include:
• An ongoing risk assessment for each third-party vendor.
• Due diligence process.
• Contract structuring and review that includes consideration of compliance requirements.
• Oversight based on risks to your organization.
In Conclusion

Fair Lending Trends

As the compliance landscape continues to change, below are some of the trends to keep in mind:

1. HMDA Plus data requirements are on the way.
2. Redlining is at the forefront.
3. REMAs exist and are being defined for you by your regulator.
4. Fair Lending is still being defined, and examiners are continuing to scrutinize institutions.
5. Examiners and community groups are more sophisticated, and more data-driven.
6. Some regulators, including the DOJ and the OCC, even have Fair Lending-focused task forces.
Fair Lending is constantly evolving, and the risks are high!

3 Fair Lending Tips

Fair Lending compliance can be complicated, but there are things you can do to make it simpler.

Here’s how:
1. Evaluate your Fair Lending compliance program, and work to improve it.
2. Analyze your data to identify Fair Lending risk that may attract the examiners’ attention.
3. Lean on the right partners, like the Arkansas Bankers Association and TRUPOINT, to achieve your compliance goals!
Questions?

About TRUPOINT Partners

TRUPOINT Partners is a regulatory compliance software and services provider based in Charlotte, NC. We help more than 500 financial institutions nationwide manage their Fair Lending, HMDA, Redlining, CRA and BSA/AML compliance, and prepare for growth.

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