

2014 Federal Interagency Fair Lending Hot Topics

Outlook Live Webinar – October 22, 2014

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Overview

- **Fair Lending Updates**
 - *Anna-Marie Tabor, Deputy Fair Lending Director, Office of Fair Lending and Equal Opportunity, Consumer Financial Protection Bureau*
- **Risk-Based Approach to Fair Lending**
 - *Tara L. Oxley, Chief, Fair Lending and CRA Examinations, Federal Deposit Insurance Corporation*
- **Fair Lending Risk Assessments**
 - *Kimberly G. Hebb, Director for Compliance Policy, Office of the Comptroller of the Currency*
- **Expectations for Compliance Management Systems**
 - *Jamie Goodson, Director, Division of Consumer Compliance Policy and Outreach, Office of Consumer Protection, National Credit Union Administration*

Overview

- **Target Pricing for Mortgages: An Emerging Fair Lending Risk**
 - *Maureen Yap, Special Counsel/Manager, Fair Lending Enforcement Section, Division of Consumer and Community Affairs, Federal Reserve Board*
- **Recent Enforcement Actions: REO Properties and Maternity Leave**
 - *Karina S. Leake, Equal Opportunity Specialist, Office of Systemic Investigations, U.S. Department of Housing and Urban Development*
- **Auto Lending Enforcement**
 - *Marta Campos, Trial Attorney, U.S. Department of Justice, Civil Rights Division, Housing and Civil Enforcement Section*

Fair Lending Updates

*Anna-Marie Tabor, Deputy Fair Lending Director
Office of Fair Lending and Equal Opportunity
Consumer Financial Protection Bureau*

CFPB's Office of Fair Lending and Equal Opportunity

Fair Lending means: “fair, equitable, and nondiscriminatory access to credit for consumers”

Our Fair Lending activities and responsibilities include:

- **Fair Lending Supervision and Enforcement** – Providing oversight and enforcement of Federal fair lending laws
- **Rulemaking** – Working with CFPB's Office of Regulations on fair lending rulemakings
- **Outreach** - Promoting fair lending compliance, education and reporting
- **Interagency Coordination** – Coordinating fair lending efforts with Federal agencies and State regulators

Topics

- Auto Updates
- Mortgage Updates
- HMDA Rulemaking

Auto Updates

- *Supervisory Highlights: Summer 2014*
- Proxy methodology paper
- Proposed rule defining larger participants in auto finance market

Indirect Auto Lending and Fair Lending Risk

- Standard policies/practices of indirect auto lenders often make them “creditors” under ECOA
- Allowing dealers discretion to increase consumer interest rates is a source of fair lending risk
- The CFPB evaluates possible discrimination in both auto lending and in other markets on a case-by-case basis
- Dealers deserve to be fairly compensated for adding value and finding financing

Indirect Auto Lending: Methods for Mitigating Fair Lending Risk

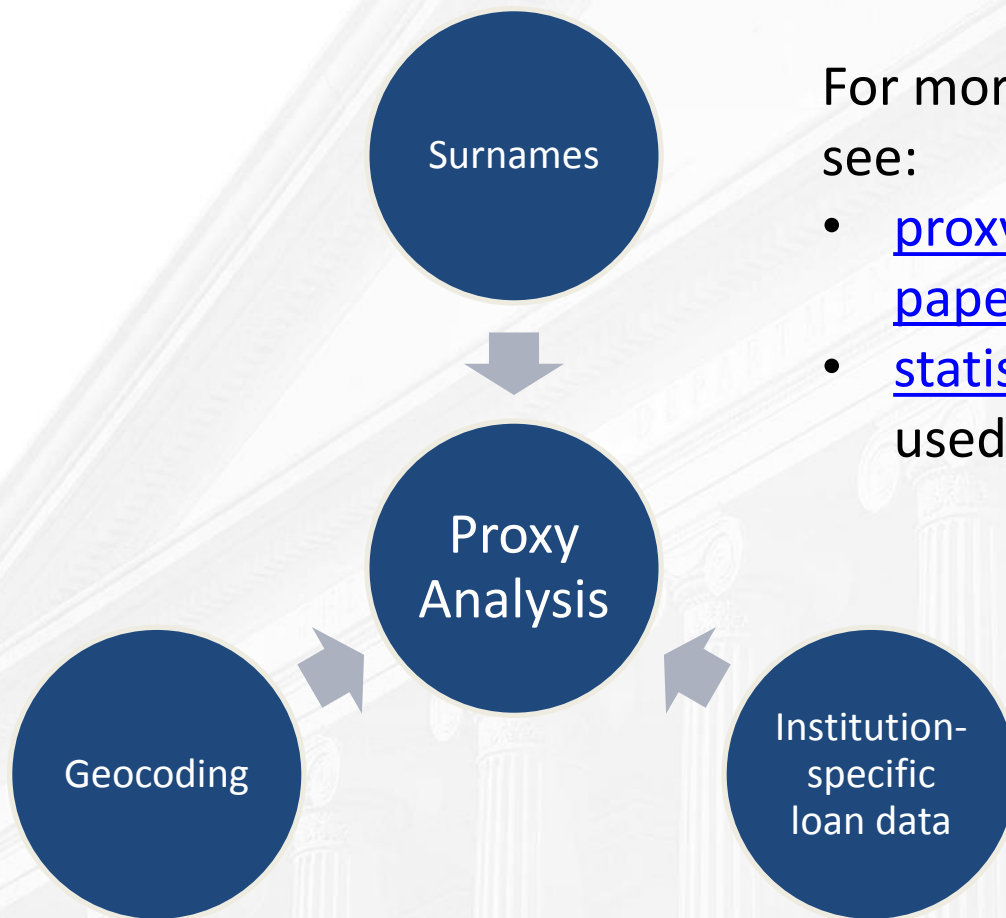
1. Compliance Management Systems (CMS)
 - Up-to-date fair lending policy statement
 - Regular fair lending training
 - Ongoing monitoring for compliance with fair lending and other policies and procedures
 - Review of lending policies for potential fair lending violations
 - Statistical analysis, depending on the size and complexity of the institution
 - Regular assessment of marketing of loan products
 - Meaningful oversight of fair lending compliance

Indirect Auto Lending: Methods for Mitigating Fair Lending Risk *(continued)*

2. Limits on maximum allowable discretionary pricing adjustments
3. Dealer compensation not based on discretionary markup

For more information, see: [Supervisory Highlights: Summer 2014](#)

CFPB's Proxy Analysis



For more information, see:

- [proxy methodology paper](#) and the
- [statistical software code](#) used to build the proxy

Proposed Larger Participant Rule

to provide more complete oversight of the auto finance market

- Nonbank auto finance companies that make, acquire, or finance 10,000 or more loans and/or leases in a year
 - About 38 auto finance companies, which originate around 90% of nonbank auto loans and leases, and in 2013 provided financing to approximately 6.8 million consumers
 - CFPB wants to ensure auto lenders are treating consumers fairly throughout the life of a loan or lease by:
 - Fairly marketing and disclosing auto finance
 - Providing accurate information to credit bureaus
 - Treating consumers fairly when collecting debts
- For more information, see the [proposed rule](#)

CFPB's

ECOA Targeted Mortgage Reviews

- CFPB's mortgage supervision program has included ECOA Targeted Reviews at institutions that receive about 40% of the applications and make about 40% of the originations reported pursuant to HMDA
- Institutions are identified for ECOA Targeted Mortgage Reviews through a risk-based prioritization process
- ECOA Targeted Mortgage Reviews generally include:
 - Statistical analysis of HMDA and additional fields
 - Review of policies and procedures for ECOA and Regulation B compliance
 - Loan file reviews

Issues Identified in Supervisory Reviews

- CFPB examination teams have observed various factors that indicate heightened fair lending risk, including:
 - Policies that consider prohibited bases in a manner that violates ECOA or presents a risk of a fair lending violation
 - Discretionary policies without sufficient controls or monitoring to control fair lending risk
 - Insufficient documentation for pricing and underwriting exceptions
 - Data inaccuracies that impair the institution's fair lending self-assessments

HMDA Proposed Rule

The Dodd-Frank Act expanded the scope of data collected and submitted under HMDA:

- Age of applicant
- Rate spread (for all loans)
- Credit score
- Non-fully amortizing payment features
- Total points and fees
- Prepayment penalty term
- Property value
- Period after which the rate may change
- Loan term
- Application channel
- As appropriate, identifiers for loan originators, loans, and property parcels
- Other information, as the CFPB may require

HMDA Proposed Rule *(continued)*

The CFPB's HMDA rulemaking notice proposed additional HMDA data points including:

- Debt-to-income (DTI) ratio
- Qualified mortgage (QM) status of the loan
- Combined loan-to-value (CLTV) ratio
- Automated underwriting systems results
- Pricing information including total origination charges; total discount points; risk-adjusted, pre-discounted interest rate; and interest rate
- Multifamily housing data
- Manufactured housing data

Comment period ends October 29, 2014. Submit your comments at <http://www.regulations.gov/#!submitComment;D=CFPB-2014-0019-0001>

Online Fair Lending Resources

- Each institution should ensure that its CMS is tailored to its operations; scope, size and complexity may vary
- For more information, review the following resources available on our website: www.consumerfinance.gov
 - [Supervision and Examination Manual](#) (and other guidance documents)
 - [Supervisory Highlights: Summer 2014](#)
 - [Proxy Methodology White Paper](#)
 - [Proxy Statistical Software Code](#)
 - [Lending Discrimination Bulletin](#)
 - [HMDA Bulletin](#)
 - [Auto Lending Bulletin](#)
 - [Responsible Business Conduct Bulletin](#)
 - [Fair Lending Report](#)
 - [Auto Finance Field Hearing](#)

Consumer Resources

Ask CFPB

- Ask CFPB is an interactive online tool that gives consumers answers to more than 1,000 questions about financial products and services, including credit cards, mortgages, student loans, bank accounts, credit reports, payday loans, and debt collection at www.consumerfinance.gov/askcfpb

Consumer Complaints

- To submit a complaint about a consumer financial product or service, consumers can visit: www.consumerfinance.gov/complaint or call 855-411-CFPB (2372). The CFPB can assist consumers in over 180 languages

The FDIC's Risk-Based Approach to Fair Lending

Tara L. Oxley, Chief

Fair Lending and CRA Examinations

Federal Deposit Insurance Corporation

Preparing for a Fair Lending Review

- Examiners request information prior to the start of an examination
- This information is used to evaluate fair lending-related risks
- This risk analysis will guide the scope and focus of the fair lending review



Assessing Fair Lending Risks

- Examine using a risk-based methodology
- Evaluate the bank's structure, operations, and compliance management system
- Identify institutional inherent risks
- Determine whether other factors help mitigate risk



Conducting Focused Reviews

- After evaluating an institution's inherent risk and mitigating factors, examiners may decide a more in-depth analysis is needed
- Examiners will keep a bank updated throughout the process
- An institution will have the opportunity to respond before the FDIC makes a final determination

Reference Materials

- FDIC's [Fair Lending Scope and Conclusions Memorandum](#)
- FFIEC [Interagency Fair Lending Examination Procedures](#)

Fair Lending Risk Assessments

*Kimberly G. Hebb, Director for Compliance Policy
Office of the Comptroller of the Currency*

Lifecycle of a Credit Product



Consequences of Lending Discrimination

- Lost opportunities
- Complaints and lawsuits
- Negative publicity
- Public protests
- Regulatory scrutiny
- Negative impact on CRA ratings
- Referral to the Department of Justice / Department of Housing & Urban Development
- Business constraints, restitution, and civil money penalties

Fair Lending Risk Assessment

- Review fair lending risk under ECOA and FHA
- Granular approach – identify risk at product level
- Product types
 - Home mortgage
 - Home equity loans & lines of credit
 - Consumer loans
 - Credit cards
 - Modifications/loss mitigation
 - Business purpose

Fair Lending Risk Assessment

(continued)

- Product features
 - Portfolio, purchased, government-backed, traditional saleable, alternative
- Delivery channels
 - Branch, loan production office, phone/mail, preapproved, internet, mobile, third party
- Underwriting
 - Centralized/decentralized, credit scoring, judgmental, third party underwriting, exceptions

Fair Lending Risk Assessment

(continued)

- Pricing
 - Standard across institution, regional, risk-based, discretionary
- Marketing
 - Standard in and across AAs/markets, targeted demographic advertising, special purpose programs, direct mail campaigns, branch level
- Originator compensation
 - Flat fee, straight salary, volume/percentage of loans, terms, portfolio growth/performance, referral

Fair Lending Risk Assessment

(continued)

- Reputation risks
 - Complaints, “Needs to Improve” ratings, CRA AAs, litigation, referrals to other agencies
- Supervisory concerns
 - Violations, MRAs, institution-identified issues, fair lending issues identified by other supervisory agencies, previous supervisory activities

Fair Lending Risk Assessment

(continued)

- Risk Management / Controls
 - Policies/Procedures
 - Training
 - Audit/Compliance Testing
 - Self-Evaluation
 - Resources

Expectations for Compliance Management Systems

Jamie Goodson, Director

Division of Consumer Compliance Policy and Outreach

Office of Consumer Protection

National Credit Union Administration

Elements of an Effective Compliance Management System

- Board of Directors and Management Oversight
- Policies and Procedures
- Training
- Monitoring/Testing and Corrective Action
- Compliance Audit
- Member Complaint Response

Board of Directors and Management Oversight

- Demonstrate clear expectations about fair lending compliance within the institution and by third party service providers
- Adopt clear policy statements about fair lending compliance
- Define clear responsibilities for fair lending compliance management
- Allocate resources appropriate for the institution's size and complexity
- Implement a fair lending audit function appropriate for the institution's size and complexity

Policies and Procedures

- Document policies and procedures
- Include sufficient detail
- Review and update frequently
- Cover all loan products and phases, such as advertising, marketing, underwriting, servicing, loss mitigation, and third party oversight
- Address reviews done before the institution introduces new lending products or modifies existing products, including—
 - Evaluation of documents and disclosures
 - System testing
 - Staff training

Training

- Educate board of directors, management, staff
 - Board of directors should receive sufficient information to understand responsibilities and resource requirements
 - Management and staff should receive specific, comprehensive training that reinforces and helps implement written fair lending policies and procedures
- Address new and existing employee training
- Maintain a fluid schedule
 - Cover regulatory changes
 - Address observed weaknesses or noncompliance

Monitoring/Testing and Corrective Action

- Schedule and complete monitoring and testing
- Determine compliance with policies and procedures
- Consider the results of internal or external audits, risk assessments, or other guidelines
- Document who monitored what and when
- Escalate findings to management and the board of directors if appropriate
- Take prompt corrective action if appropriate

Compliance Audit

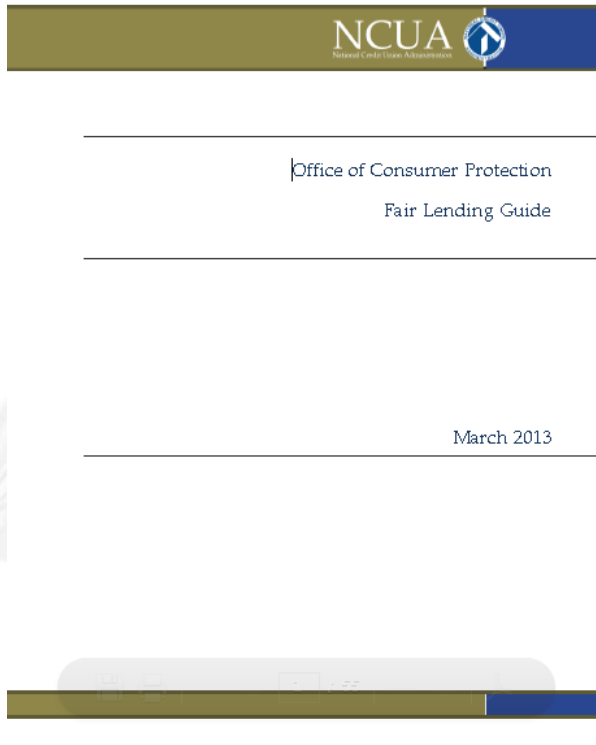
- Fair lending risk assessment
- Comparative file reviews
- HMDA analysis
- Evaluation of underwriting and pricing parameters
- Demographic analysis
- Review of—
 - Exception and override reports
 - Fair lending policies and procedures
 - Fair lending training
 - Marketing and advertising practices

Complaint Response

- Be responsive
- Be responsible
- Organize, retain, and use complaint information

NCUA Fair Lending Resources

NCUA Fair Lending Guide



Additional Resources

- Best Practices
- FAQs
- Regulatory Alerts
- Webinars
- HMDA Resources
- Interagency Fair Lending Examination Procedures



Target Pricing for Mortgages An Emerging Fair Lending Risk

*Maureen Yap, Special Counsel/Manager
Fair Housing Enforcement Section
Division of Consumer and Community Affairs
Federal Reserve Board*

The Federal Reserve's Fair Lending Authority

	Federal Reserve	CFPB
SMB above \$10B	Fair Housing Act (FHA)	Equal Credit Opportunity Act (ECOA)
SMB of \$10B or less	FHA, ECOA	

- The Federal Reserve Board (Board) supervises:
 - Over 800 state member banks (SMBs)
 - SMBs above \$10B for compliance with the FHA
 - SMBs of \$10B or less for compliance with the FHA, ECOA and Regulation B
- The Consumer Financial Protection Bureau (CFPB) supervises:
 - Institutions above \$10B for compliance with the ECOA and Regulation B
- Thus, the Federal Reserve and the CFPB share supervision authority for fair lending in mortgages for SMBs above \$10B

Federal Reserve Referrals

- Pursuant to the ECOA, if the Board has reason to believe there is a pattern or practice of discrimination, the Board must refer the matter to the U.S. Department of Justice (DOJ)
- The Federal Reserve has referred a number of matters to the DOJ, including matters regarding:
 - ✓ Pricing
 - Mortgages
 - Indirect Auto Lending
 - Unsecured Loans
 - Mortgage Discount Points (Fair Lending and UDAP)
 - ✓ Redlining
 - ✓ Underwriting
 - Maternity Leave Discrimination
 - Disability/Public Assistance Discrimination
 - ✓ Spousal Signatures
 - ✓ Credit Reporting

Federal Reserve Pricing Reviews

- Federal Reserve examiners conduct fair lending pricing reviews as part of consumer compliance exams
 - Based on the 2009 Interagency Fair Lending Examination Procedures, examiners will look for the following risk factors:
 - Policies or procedures that indicate discretion in pricing and/or exceptions
 - Financial incentives based on the terms or conditions of the loan
 - Loan data that indicates pricing disparities on a prohibited basis
 - Complaints

Target Pricing for Mortgages: An Emerging Fair Lending Risk

Overview

- Some banks are setting a different target price (interest rate and fees) for each mortgage loan originator to offer to consumers
- Fair lending risks can arise if the high-price mortgage loan originators are concentrated in minority areas
- The Federal Reserve has had one referral on this issue

Target Pricing – Regulation Z

- Since April 2011, Regulation Z's mortgage loan originator (MLO) compensation rule has prohibited a bank from paying a loan officer based on the terms or conditions of the loan, including the price. This reduces the fair lending risk at the MLO level
- However, the fair lending risk for mortgage pricing is not eliminated
- Nonproducing managers, branches, and the bank may still derive compensation or profit based on the price of the loan, and some Regulation Z-compliant models can significantly increase fair lending risk

Target Pricing – The “Target Price”

- Target Price: Some banks that originate loans for the secondary market now set a “target price” for each MLO, which can be calculated with any combination of a higher interest rate and/or discretionary fees
- Compensation Plan: The MLO is paid a fixed percentage of the loan amount. Thus, the compensation plan may comply with Regulation Z
- Software: Some banks reinforce the target price for the MLOs by using software that only shows the MLO the interest rate and fee options based on their approved target price

Target Pricing – Interest Rate Example

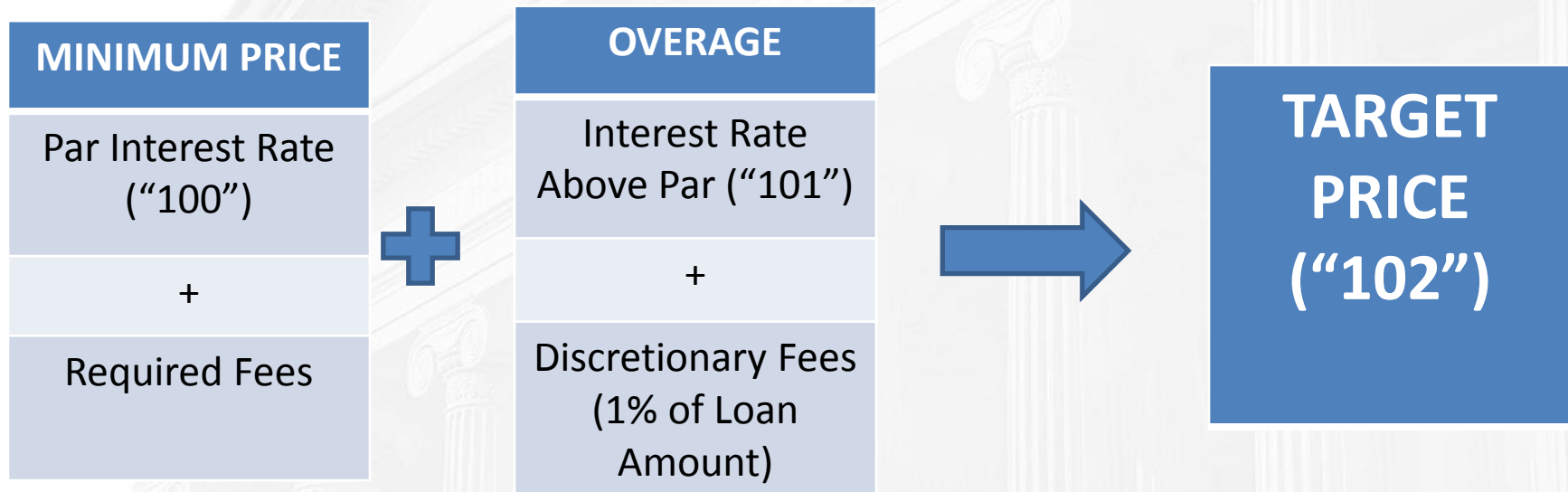
- The investor sets a “par” interest rate that generates a net investor price of “100.” The par interest rate is already adjusted for risk based on the credit characteristics of the borrower
- An MLO with a target price of “101” must generate revenue equal to 1% of the loan amount through any combination of interest rate and fees
- To reach the target price and generate higher profits to the bank using the interest rate, the MLO can charge the borrower the interest rate available at an investor price of “101”
- The additional interest rate (or “overage”) is not based on the borrower’s credit characteristics

Target Pricing – Fee Example

- An MLO with a target price of “101” must generate revenue equal to 1% of the loan amount through any combination of interest rate and fees
- To reach the target price and generate higher profits to the bank using fees, the MLO can charge the borrower discretionary fees equal to 1% of the loan amount
- The additional discretionary fees (or “overage”) are not based on the borrower’s credit characteristics

Target Pricing – Combined Interest Rate and Fees Example

- An MLO with a target price of “102” must generate revenue equal to 2% of the loan amount through any combination of the interest rate and fees



Target Pricing – Fair Lending Risk

- Fair lending risk arises if MLOs with higher target prices are concentrated in minority neighborhoods. These higher target prices will be based solely on discretion at the bank level and not on the credit characteristics of the borrower. That is, a loan made at the 103 target price could have been made to the same borrower at the 101 target price
- For example:

	MLO-A	MLO-B
Target Price	101	103
Customer Base	Mostly Non-Hispanic Borrowers	Mostly Hispanic Borrowers

Target Pricing – Fair Lending Risk

(continued)

- Hispanic applicants dealing with mortgage loan originator B, who has a 103 target price, will always receive a higher price than similarly-situated non-Hispanic applicants dealing with loan originator A, who has a 101 target price
- This scenario can lead to statistically significant, unexplained disparities in pricing (APR, interest rate, fees, overages)

Target Pricing – Best Practices

- Banks that set target prices for MLOs should:
 - Review the MLO compensation plan for compliance with Regulation Z
 - Recognize that setting different target prices for MLOs raises fair lending risks
 - Monitor pricing by race/ethnicity across MLOs, including the APR, interest rate, fees, and overages; use statistical analysis if there is sufficient volume
 - Recognize the risk of potential reverse redlining where high-price MLOs are concentrated in minority neighborhoods; consider mapping loans by target price

Resources

- [Consumer Compliance Outlook](#) – Federal Reserve publication dedicated to consumer compliance
- [Outlook Live](#) – Federal Reserve webinars on consumer compliance topics
- [Community Banking Connections](#) – Federal Reserve publication and website dedicated to providing guidance, resources and tools for community banks
- [Interagency Fair Lending Examination Procedures and Appendix](#)

Recent Enforcement Actions: REO Properties and Maternity Leave

Karina S. Leake, Equal Opportunity Specialist

Fair Housing and Equal Opportunity

Office of Systemic Investigations

U.S. Department of Housing and Urban Development

Maintaining and Marketing REO Properties

- The Department of Housing and Urban Development has ongoing investigations into lenders' maintenance and marketing of REO properties
- The lenders being investigated are alleged to have maintained and marketed foreclosed homes in majority white neighborhoods in a much better manner than in majority African-American or Hispanic neighborhoods

REO Maintenance

- Structure—broken windows, unsecured doors...
- Curb appeal—trash, overgrown grass, accumulated mail...
- Water damage—mold, damaged roof...
- Paint—graffiti, peeling paint...
- Gutters—missing, damaged...

REO Marketing

- Missing or broken “For Sale” sign
- Marketed as distressed property
- Visible foreclosure signage

Wells Fargo REO Settlement

June 2013 HUD entered settlement with Wells Fargo regarding the maintenance and marketing of its bank-owned homes

- Result of a complaint filed in April 2012 with HUD
- Complaint alleged Wells Fargo's bank-owned properties in White areas were much better maintained and marketed than such properties in African-American and Latino neighborhoods
- Agreement between Wells Fargo, National Fair Housing Alliance, and HUD total \$42 million

Wells Fargo REO Settlement

(continued)

Wells Fargo will provide \$38.5 million to fair housing organizations in 19 cities for:

- Promoting homeownership
- Neighborhood stabilization
- Property rehabilitation
- Development in communities of color

Wells Fargo REO Settlement

(continued)

- Wells Fargo will implement best practices for the maintenance and marketing of their REO properties
- Enhance its First Look program
- Make it easier for the public to get information about its REO properties
- Develop an enhanced fair housing training program on REO issues for its employees

REO Best Practices

- Hire local vendors, preferably in the subject community, to perform preservation and maintenance services
- Check! Check! Check! Set standards and inspect what you expect from vendors hired to perform preservation and maintenance services

REO Best Practices *(continued)*

- Partner with local fair housing agencies to sell REOs to people who will occupy the properties rather than to investors
- Sell REO properties to fair housing agencies for community use
- Offer alternative financing solutions:
 - Provide access to flexible capital for acquisition and rehabilitation
 - Offer alternatives to permanent financing for low balance loans or credit challenged buyers

Maternity Leave and Fair Lending Issues

- Sex
- Familial status
- Pregnancy
- Securing legal custody of child under age of 18
- Maternity or paternity leave status
- Disability
- Medical complications related to pregnancy

Maternity Leave and Fair Lending Violations

Discriminatory Statements or Terms

- Lender says it cannot approve or fund the loan due to maternity leave status
- Lender says it cannot use maternity leave related income to underwrite the loan

Wells Fargo

Maternity Leave Settlement

- September 2014 – \$5 million total
- The six complainant households receive a total of \$165,000 in damages
- The agreement includes a victims fund of up to \$5 million, with each claimant to receive up to \$20,000 per household
- Unspent funds in the victims fund will go to support fair housing organizations
- Wells Fargo adopted a national temporary leave policy that is consistent with the requirements from Fannie, Freddie and FHA

Maternity Leave Underwriting Best Practices

- Lenders should adopt a written maternity leave underwriting policy that includes the following:
 - Mortgage applicant is not required to return to work before closing
 - Mortgage applicant on maternity leave is considered employed
 - Lender must not ask mortgage applicant about future maternity leave plans

U.S. Department of Housing and Urban Development

1-800-669-9777

to report housing discrimination

www.hud.gov

Auto Lending Enforcement

Marta Campos, Trial Attorney

U.S. Department of Justice

Civil Rights Division

Housing and Civil Enforcement Section

DOJ Auto Lending Enforcement

- *United States v. Auto Fare, Inc., et al.* (W.D.N.C.)
- *United States v. Ally Financial Inc. and Ally Bank* (E.D. Mich.)
- *United States v. Nara Bank and Union Auto Sales* (C.D. Cal.)
- *United States v. Pacifico Ford, Inc.* and *United States v. Springfield Ford, Inc.* (E.D. Pa.)
- *Amicus* brief in *Cason v. Nissan Motor Acceptance Corp.* (M.D. Tenn.)

United States v. Ally Financial Inc. and Ally Bank (2013)

- Formerly GMAC
- One of the nation's largest auto lenders
- November 2013 referral from CFPB
- Investigation conducted jointly with CFPB

United States v. Ally Financial Inc. and Ally Bank (2013) (continued)

- Complaint alleged Ally charged minority borrowers higher interest rate markups on indirect auto loans
- Dealers granted broad and subjective discretion by Ally to mark up buy rate, subject to caps
- Ally did not conduct sufficient monitoring to detect race or national origin disparities

United States v. Ally Financial Inc. and Ally Bank (2013) (continued)

- Statistical disparities:
 - African-Americans: 29 bps
 - Hispanics: 20 bps
 - Asian/Pacific Islanders: 22 bps

*99% confidence level
- DOJ and CFPB used Bayesian Improved Surname Geocoding (BISG) proxy methodology to estimate race and national origin

United States v. Ally Financial Inc. and Ally Bank (2013) (continued)

- December 2013 settlement
- \$80 million settlement fund
- \$18 million civil monetary penalty to CFPB
- Ally must refund discriminatory overcharges for the next three years unless disparities significantly reduced
- New CMS to monitor for disparities

United States v. Auto Fare (2014)

- Defendants operate “Buy Here Pay Here” auto dealerships, providing direct financing for used cars
- Customers are only required to make down payment and prove residency and income
- Joint investigation with NC DOJ
- Complaint filed January 2014

United States v. Auto Fare (2014)

(continued)

- Complaint alleges that defendants targeted borrowers for predatory loans without meaningful assessment of creditworthiness
- Predatory loan features:
 - Excessive sales price
 - Very high down payment
 - Disproportionately high APR

United States v. Auto Fare (2014)

(continued)

- Complaint alleges that African-American borrowers were targeted for predatory loans
- Complaint alleges owner used racial slurs and epithets and made derogatory statements about African-American customers
- Many of defendants' customers defaulted and/or had vehicles repossessed

Want more information?

- Former AAG Tom Perez testified about fair lending before Senate Judiciary Committee:
<http://www.justice.gov/crt/opa/pr/speeches/2012/crt-speech-120307.html>
- All fair lending complaints and settlements are on HCE's website:
<http://www.justice.gov/crt/about/hce/caselist.php>



Questions?