
Best Practices for Complying with Fair Lending Laws

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Fair Lending is a Priority

- Fair lending is the law
- It is also a good business practice
- Consequences of noncompliance
 - Injunctive Relief
 - Restitution
 - Civil Money Penalties
 - Reputation risks
 - Affect on Community Reinvestment Act and compliance ratings

Overview of the Fair Lending Laws

- Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691 *et seq.*
 - Implemented by Regulation B, 12 C.F.R. Part 202
- Fair Housing Act, 42 U.S.C. § 3601 *et seq.*
 - Implemented by 24 C.F.R. Part 100
- Interagency Policy Statement on Discrimination in Lending (1994)
- Nondiscrimination Requirements, 12 C.F.R. Part 128

Overview of the Fair Lending Laws (cont.)

- Equal Credit Opportunity Act
 - Prohibits discrimination in any aspect of a credit transaction
 - Implemented by Regulation B which was reissued by the Consumer Financial Protection Bureau (CFPB) without substantive changes
 - ECOA prohibits discrimination:
 - on the basis of race, color, national origin, religion, sex, marital status, or age;
 - because income is from public assistance; or
 - because a right has been exercised under the Consumer Credit Protection Act
 - Exception:
 - ECOA permits creditors to favor “elderly” applicants (i.e. 62 years or older)

Overview of the Fair Lending Laws (cont.)

- The Fair Housing Act
 - Prohibits discrimination in all aspects of “residential real-estate related transactions,” including making loans
 - Prohibits discrimination on the basis of
 - race or color
 - national origin
 - religion
 - sex
 - familial status
 - disability
- Applicability
 - ECOA and the Fair Housing Act both apply to residential mortgage lending
 - ECOA also applies to all types lending, including non-residential lending

Overview of the Fair Lending Laws (cont.)

- Under the fair lending laws, a creditor may not discriminate on a prohibited basis
- Discriminatory conduct includes:
 - Failing to provide information or providing different information regarding credit availability, application procedures, or lending standards
 - Discouraging or selectively encouraging applicants
 - Refusing to extend credit or applying different lending standards
 - Making loans on different terms, including the amount, interest rate, maturity, or type of loan
 - Treating borrowers differently in servicing loans or invoking default remedies

Overview of the Fair Lending Laws (cont.)

- Types of Lending Discrimination
 - Overt discrimination
 - Lenders generally do not engage in overt discrimination
 - Disparate treatment
 - May be evidenced by statements revealing that a creditor explicitly considered prohibited factors
 - Found where differences in treatment are not fully explained by legitimate nondiscriminatory factors
 - Disparate impact
 - Found where lending policies are applied equally, but nevertheless disproportionately disadvantage certain persons on a prohibited basis
 - If there is a disparate impact, the lender must show that the policy or practice serves a legitimate business purpose

Overview of the Fair Lending Laws (cont.)

- The disparate impact theory is also known as the “effects test”
 - Regulation B states that Congress intended the “effects test” concept to be applicable to a creditor’s determination of creditworthiness
 - Effects test is outlined in the employment field by Supreme Court cases
 - Title VII of the Civil Rights Act of 1964 prohibits discriminatory employment practices
 - In applying the discriminatory effects standard
 - under ECOA, the agencies and courts have used Title VII’s burden-shifting framework
 - under the Fair Housing Act, HUD and many federal courts of appeals have used a burden-shifting approach

Overview of the Fair Lending Laws (cont.)

- HUD's Proposed Rule on Discriminatory Effects Standard
 - Would establish uniform standards for determining when a housing practice with a discriminatory effect violates the Fair Housing Act
 - The standard would be the same under both ECOA and the Fair Housing Act
 - Burden shifting:
 - Plaintiff must make a *prima facie* showing of disparate impact
 - Burden of proof then shifts to the defendant to justify its actions
 - Plaintiff then has the burden of proving a less discriminatory alternative

Enforcement of the Fair Lending Laws

- Policy Statement on Discrimination in Lending (1994)
 - Issued by the federal banking agencies, DOJ, HUD, the FTC, and several other agencies
 - Emphasizes that the agencies will not tolerate lending discrimination in any form
 - Discusses what constitutes lending discrimination under ECOA and the Fair Housing Act
 - Answers questions about how the agencies would respond to lending discrimination and what steps lenders might take to prevent discriminatory lending practices
- OTS' nondiscrimination requirements are recodified at 12 C.F.R. Part 128

Enforcement of the Fair Lending Laws (cont.)

■ Administrative Enforcement

- The federal banking agencies may take action under 12 U.S.C. § 1818 to enforce ECOA
- Such actions may seek
 - Injunctive relief
 - Restitution
 - Civil money penalty
- HUD may bring a case to a hearing before an administrative law judge under the Fair Housing Act

■ Civil Action

- Both ECOA and the Fair Housing Act may be enforced by DOJ through a civil action

CFPB's Supervisory Guidance

- CFPB examiners have found the following features at institutions with well developed fair lending compliance programs:
 - An up-to-date fair lending policy statement
 - Regular fair lending training for employees, officers, and board members
 - Ongoing monitoring for compliance with fair lending policies and procedures
 - Ongoing monitoring for compliance with other policies and procedures intended to reduce fair lending risk (such as controls on loan originator discretion)
 - Review of lending policies for potential fair lending violations, including potential disparate impact
 - Regular statistical analysis for disparities based on prohibited class in pricing, underwriting, or other aspects of credit transaction — including both mortgage/nonmortgage products, such as credit cards, auto lending, and student lending
 - Regular assessment of marketing
 - Meaningful oversight by management and the board

Attorney-Client Privilege

- Fair lending reviews should be performed at the direction and under the supervision of counsel
 - Establishing attorney-client relationship
 - Attorney work product
- Counsel should assist with
 - investigating factual disputes
 - developing legal arguments
 - writing advocacy submissions to the agencies that have alleged unlawful discrimination

Proactive Fair Lending Reviews

- Proactive Reviews
 - Institutions should conduct proactive fair lending reviews with the advice of legal counsel
- Industry Standard
 - Robust computer regression models using up-to-date models
 - Customized to the institution's lending policies and practices – one size does not fit all
 - Should supplement HMDA data with variables such as
 - Credit scores
 - “Loan-to-value” ratios
 - “Debt-to-income” ratios (and others discussed later...)
 - May help identify legitimate explanations for disparities

Proactive Fair Lending Reviews (cont.)

- Refining the Models
 - Identify driver of any protected class disparities, such as
 - particular geographic area (e.g., an MSA)
 - particular broker
 - particular product
- Matched-Pair File Review
 - Supplements regression analyses
 - Compares ***similarly situated*** protected class and non-protected class applicants who received different credit decisions or terms
 - Disparities may be fully explained by legitimate, nondiscriminatory factors supporting the different credit decisions / terms that were not included in the model

Other Best Practices

- An institution should, with the help of counsel:
 - Review its lending policies and practices
 - Review its compliance management systems
 - Review new products in the development stage
 - Regularly review and enhance its fair lending training program
 - Identify aspects of underwriting/pricing process that involve discretion
 - Monitor the lending practices of its brokers and other agents
 - Compare its geographical lending profile with those of similar lenders to avoid allegations of redlining

Banking Agency Referrals to Dept. of Justice

■ Referrals to DOJ

— Mandatory

- A banking agency must refer a case to the DOJ if the agency has reason to believe that one or more creditors has engaged in a pattern or practice of violating ECOA

— Discretionary

- A banking agency may refer a case to the DOJ if the agency has reason to believe that one or more creditors has violated ECOA

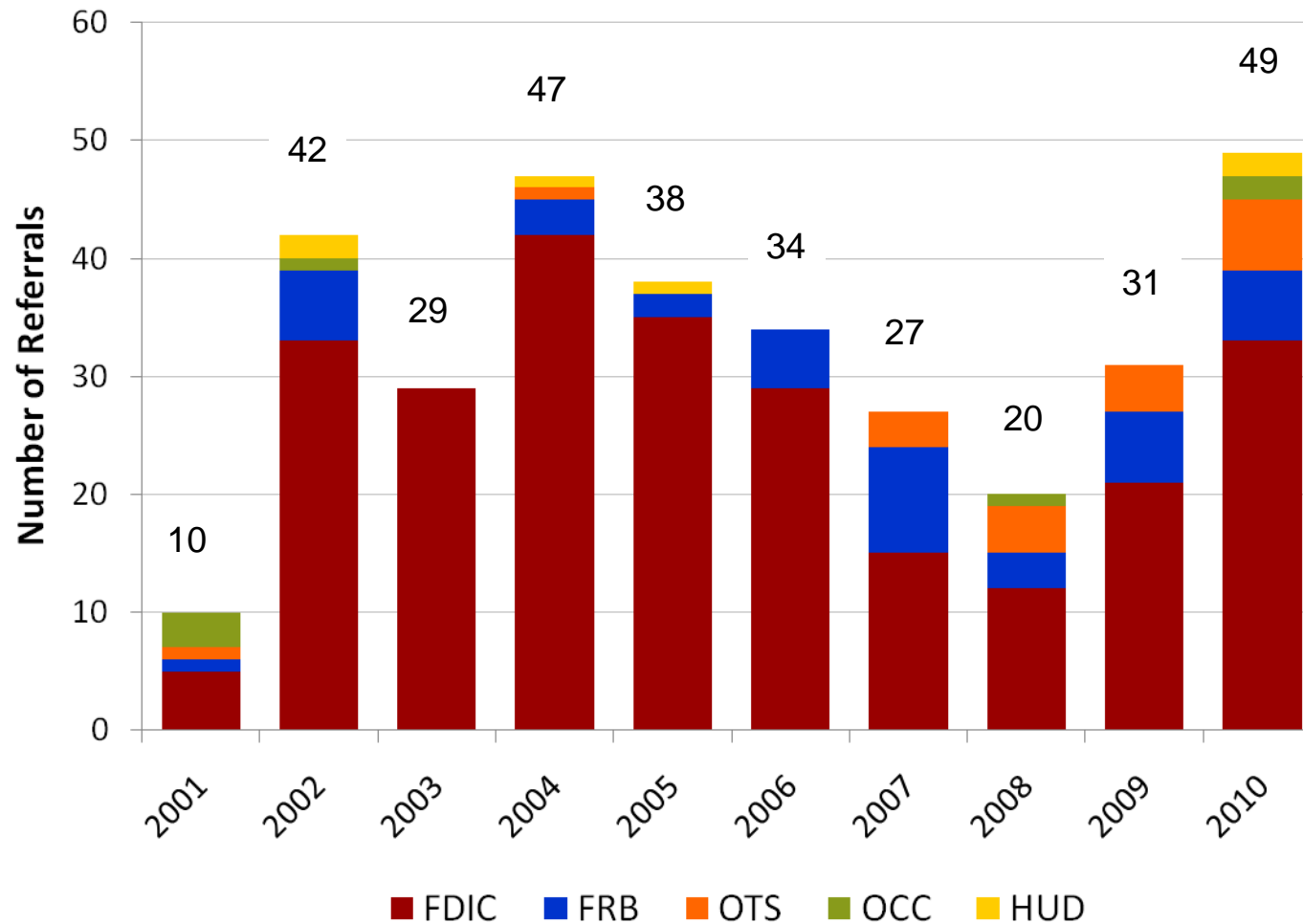
■ Notice to HUD

- If a banking agency (i) has reason to believe that a violation of ECOA has occurred, (ii) has reason to believe that the alleged violation would be a violation of the Fair Housing Act, and (iii) does not refer the case to the DOJ, the agency must notify HUD of the violation

HUD's Referrals Under the Fair Housing Act

- HUD's Complaint, Conciliation, and Investigation Process
 - A consumer or consumer group may file a complaint against a lender
 - Within 10 days of filing a complaint, HUD must serve notice on parties
 - Within 100 days after the filing, HUD must complete an investigation of the alleged discriminatory practice (unless impracticable to do so)
 - While HUD is investigating, it must attempt conciliation between the parties, which may provide for binding arbitration of the dispute
 - Participation by the parties is voluntary
- If respondent breaches the conciliation agreement, HUD must refer the matter to DOJ
- If HUD has reason to believe that any person or group of persons is engaged in a pattern or practice of violation of the Fair Housing Act, HUD must refer the case to DOJ

DOJ Referrals by Regulatory Agencies – 2001 to 2010



Source: The Attorney General's 2010 Annual Report to Congress Pursuant to the Equal Credit Opportunity Act Amendments of 1976; April 5, 2011

Referrals to DOJ by Bank Agencies / HUD / FTC

- 29 Fair Lending Referrals to DOJ in 2011
 - Federal Deposit Insurance Corporation (FDIC) – 14
 - Federal Reserve Board (FRB) – 7
 - Office of Thrift Supervision (OTS) – 4
 - Office of the Comptroller of the Currency (OCC) – 1
 - Department of Housing and Urban Development (HUD) – 1
 - Federal Trade Commission - 2
 - National Credit Union Administration (NCUA) – 0
- 49 ECOA-Related Referrals to DOJ in 2010
- 109 referrals to DOJ from 2009 to 2011
 - 55 involved discrimination on the basis of race / national origin
 - This total greatly exceeds the 30 race / national origin referrals that DOJ received from 2001 to 2008

Referrals to DOJ (cont.)

- Breakdown of 2011 Referrals*
 - Race or national origin → 18
 - Marital status → 5
 - Age → 4
 - Gender → 4
 - Exercise of rights protected under the Consumer Credit Protection Act → 1
 - Source of income → 1
 - Familial status → 1

*Some referrals involved multiple protected classes

DOJ Evaluation of Referrals

- Upon receipt of a referral, DOJ determines whether to:
 - Open an investigation,
 - Threaten to file a lawsuit in federal court, or
 - Return the matter to the regulator for administrative enforcement
- Referrals that are most likely to be returned generally have the following characteristics:
 - Practice has ceased and little chance it will be repeated
 - Violation may have been accidental or arose from ignorance of technical requirements, such as spousal signature violations
 - There were few potential victims or *de minimis* harm to any potential victims

DOJ Evaluation of Referrals

- Referrals that would likely be considered for litigation by DOJ have one or more of the following characteristics:
 - The practice could cause serious financial or emotional harm to members of protected classes (e.g., discrimination in underwriting, pricing, or provision of lender services);
 - The practice is not likely to cease without court action;
 - The protected class members harmed by the practice cannot be fully compensated without court action;
 - Damages for victims, beyond out-of-pocket losses, are necessary to deter the lender (or others like it) from treating the cost of detection as a cost of doing business; or
 - The agency believes the practice to be sufficiently common in the lending industry, or raises an important issue, so as to require action to deter lenders

Recent Enforcement Actions and Settlements

- Luther Burbank Savings (Sept. 2012)
 - DOJ settled claims a pattern or practice of discrimination in violation of the FHA and ECOA
 - DOJ alleged that a \$400,000 minimum loan amount policy had a disparate impact on African-American and Hispanic borrowers
 - The settlement required the bank to invest:
 - \$450,000 in community development partnerships
 - \$300,000 in targeted marketing and advertising
 - \$150,000 in consumer education
 - \$1.1 million in a special financing program
 - It also required the bank to subsidize covered transactions through one or more specified means

Recent Enforcement Actions and Settlements (cont.)

- Countrywide Financial Corporation (Dec. 2011)
 - DOJ settled claims of race, national origin, and marital status discrimination in residential mortgage lending with Countrywide (acquired by Bank of America Corporation in 2008)
 - The claims were the largest pattern or practice lending discrimination violations of the Fair Housing Act and ECOA ever alleged by DOJ's Civil Rights Division
 - The settlement required Countrywide to pay \$335 million to alleged victims of discrimination

Recent Enforcement Actions and Settlements (cont.)

- Citizens Republic Bancorp, Inc. (June 2011)
 - Settled claims of redlining in the Detroit area
 - DOJ alleged that Citizens and its bank subsidiaries had failed to provide their home mortgage lending services to the residents of majority African-American neighborhoods on an equal basis as those services were provided to residents of predominantly white neighborhoods in the Detroit metro area
 - The settlement required Citizens to
 - open a loan production office in an African-American neighborhood in Detroit
 - provide \$1.5 million in a special financing program
 - provide \$1.625 million to match grants of the City of Detroit to homeowners, and
 - spend \$500,000 on advertising, marketing, and consumer financial education

Recent Enforcement Actions and Settlements (cont.)

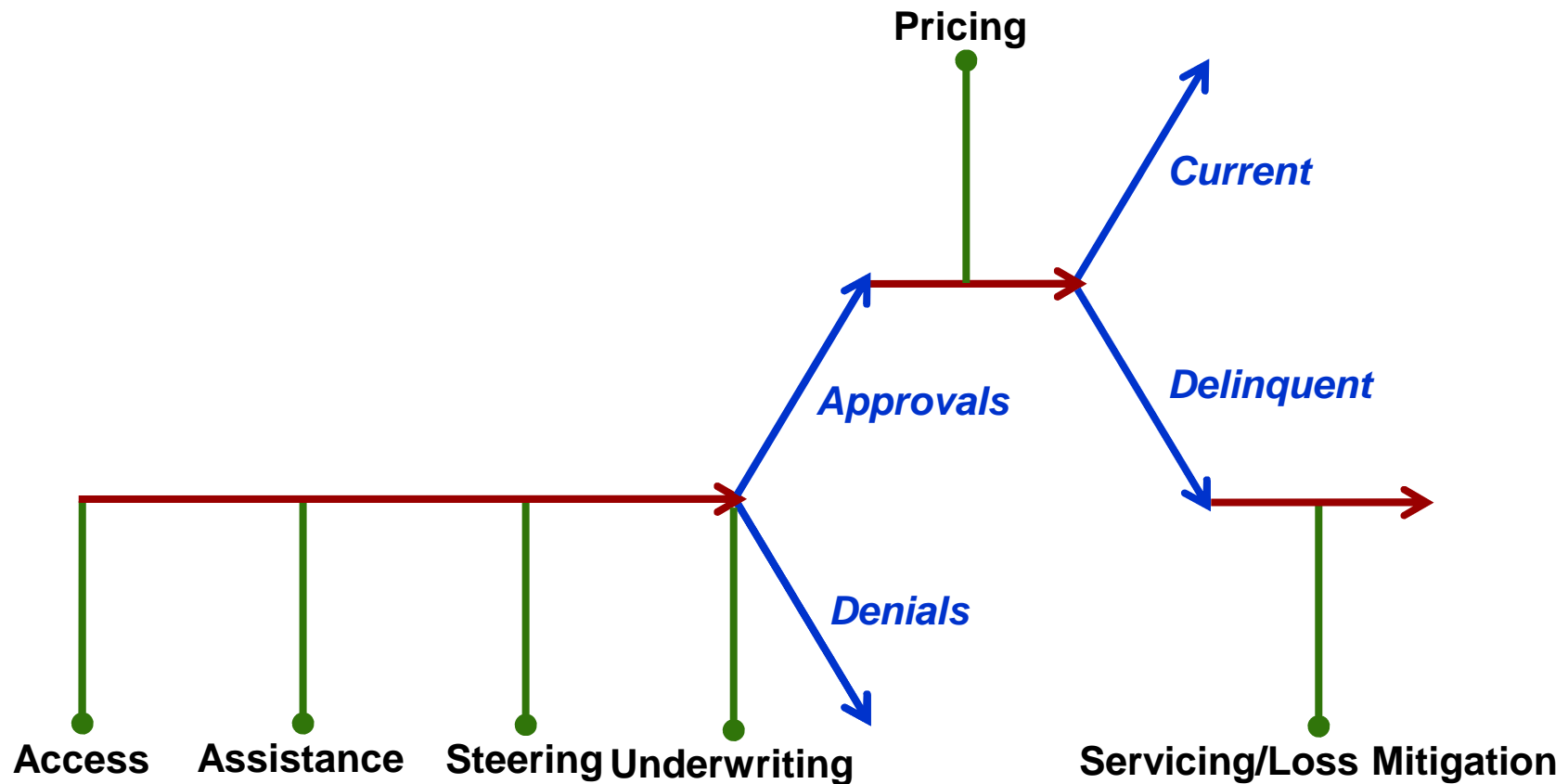
- AIG Federal Savings Bank and Wilmington Finance Inc. (Mar. 2010)
 - DOJ settled allegations of discrimination against African American borrowers in loan pricing with AIG FSB and WFI
 - DOJ alleged that AIG FSB and WFI charged higher fees on wholesale loans to African American borrowers and failed to supervise or monitor brokers in setting broker fees
 - The settlement required AIG FSB and WFI to
 - pay up to \$6.1 million to African American customers charged higher fees, and
 - invest at least \$1 million in consumer financial education

Case	Main Allegations	Settlement Amount
United States v. Countrywide Financial Corporation (2012)	Disparate impact on the basis of race and national origin from the use of discretion in retail and wholesale mortgage pricing and product placement. Marital status discrimination resulting from encouraging non-applicant spouses to sign quit-claim deeds when not required.	\$335 million
United States v. Wells Fargo Bank, N.A. (2012)	Disparate impact on the basis of race and national origin from the use of discretion in both mortgage broker pricing and the placement of borrowers in non-prime loan products, for which brokers earned greater compensation.	\$175 million and potential additional liability with respect to retail borrowers
United States v. SunTrust Mortgage, Inc. (2012)	Disparate impact on the basis of race and national origin from the use of discretion in retail and wholesale mortgage pricing.	\$21 million
United States v. GFI Mortgage Bankers Inc. (2012)	Disparate impact on the basis of race and national origin from the use of discretion in retail mortgage pricing.	\$3.555 million
United States v. PrimeLending (2011)	Disparate impact on the basis of race from the use of discretion in retail mortgage pricing.	\$2 million
United States v. C&F Mortgage Corp. (2011)	Disparate impact on the basis of race and national origin from the use of discretion in retail mortgage pricing.	\$140,000
United States v. Nixon State Bank (2011)	Disparate impact on the basis of national origin from the use of discretion in pricing unsecured consumer loans.	\$100,000
United States v. Bank of America, N.A. (2012)	Discrimination on the basis of receipt of public assistance income or handicap.	\$1,000 - \$5,000 per borrower, plus \$25,000 and \$50,000 for complainants
United States v. Luther Burbank Savings (2012)	Disparate impact on the basis of race and national origin from imposing a minimum loan amount of \$400,000 in wholesale mortgage lending.	\$91,600

Areas of Increased Regulatory and DOJ Scrutiny

- Disparate impact of discretionary pricing policies
- Discrimination in underwriting
- Steering minority borrowers into less favorable loans
- Redlining and reverse redlining
- Discrimination in servicing and loss mitigation
- Non-mortgage lending

OCC Fair Lending Screening Process



Note: Adapted from "Fair Lending Screening at the OCC" presented by OCC's Fair Lending Director at CBA LIVE 2010

Overview of Fair Lending Statistical Analyses

- Analyses
 - Underwriting
 - Pricing
 - Fees (Broker Compensation and Overages/Underages)
 - Redlining
 - Loss Mitigation Outcomes (Servicing and Foreclosure Actions)
- Comparative File Review
- Peer Analyses

First Steps

- Statistical analyses are not conducted in isolation
- Requires understanding of:
 - Policies and Procedures
 - Loan Products
 - Marketing Efforts
 - Pricing Models

Common Limitations Requiring Correction

- Broad discretion allegedly resulted in a “disparate impact” on a prohibited basis
- A lack of clear policies and/or controls governing the exercise of discretion (e.g., “Subjective and unguided pricing adjustments ... not based on a borrower’s objective credit characteristics”)
- Little or no documentation of the business rationale for discretionary pricing adjustments
- Financial incentives for loan originators to charge higher rates or fees, or to steer borrowers to higher-cost products
- A lack of effective fair lending monitoring or corrective action

Examples of Policies and Procedures Needed

- Policies defining standards for discretionary pricing and fees, such as
 - defined limits on pricing discretion
 - written explanations for amounts charged in excess of some benchmark (including from brokers)
 - pre-funding review to ensure that loans comply with pricing policies
 - a prohibition on funding loans that do not comply
 - refunds for inadvertently funding loans that do not comply
- Documentation of rate reductions provided in exchange for discount points and objective criteria used in pricing, including rate sheets
- Policies and procedures to explain the benefits and costs of alternative loan products to borrowers (in steering cases)
- Retention of records related to monitoring and corrective action
- “30-30-100” rule for analysis means that monitoring must be conducted for each MSA, branch, and originator for which there are at least 30 loans for each of the two race/ethnicity group being compared, and 100 total loans in the data sample for the two groups combined

Actions Required by Settlements

- A fair lending monitoring program that includes the following:
 - quarterly reviews of pricing outcomes in terms of note rate, APR, broker compensation, and any fees the lender retains for itself or pays to employees (as applicable)
 - aggregate-, MSA-, branch- and originator-level monitoring (subject to a “30-30-100” sample size threshold)
 - monitoring results presented to and approved by the Board of Directors
 - corrective action for “unjustified” disparities that are statistically significant at the 95% confidence level, including potential financial remediation, policy/procedure changes and/or disciplinary action
 - monitoring of product placement (in steering cases)
- Equal credit opportunity training for managers, loan originators, and other employees/agents in the loan origination process
- A complaint resolution process, including documentation of complaints and resolutions

Statistical Analysis of Underwriting and Pricing

Based upon a review of underwriting guidelines and rate sheets, Charles River Associates develops customized statistical models that may control for factors such as the following:

Underwriting Analysis

- Loan Purpose
- Occupancy Status
- Property Type
- Presence of a Co-Applicant
- Loan Amount
- Application Week
- Debt-to-Income Ratio
- Loan-to-Value Ratio
- Applicant Credit Score
- Automated Underwriting Decision
- Detailed Loan Product
- MSA

Pricing Analysis

- Loan Purpose
- Occupancy Status
- Property Type
- Loan Amount
- Rate Lock Week
- Loan-to-Value Ratio
- Borrower/Co-borrower Credit Score
- Detailed Loan Product
 - Govt/conventional
 - ARM/FRM
- Loan Term
- MSA

National Denial Rates through 2011

Table 9: Denial Rates by Race/Ethnicity and Year

Race/Ethnicity	2006	2007	2008	2009	2010	2011
African-American	37%	45%	47%	36%	35%	35%
Hispanic	30%	38%	41%	30%	28%	27%
Asian	22%	26%	26%	20%	19%	19%
Non-Hispanic White	23%	26%	26%	19%	19%	20%

Source: 2006–2011 HMDA Data

Hypothetical Lending Institution
Fair Lending Analysis of HMDA Data - 2011
Distribution of Loan Applications by Applicant Race/Ethnicity and Action Taken

Applicant Race/Ethnicity	Action							
	Total		Originated		Approved/Not Accepted		Denied	
	Count	% of Total	Count	% of Total	Count	% of Total	Count	% of Total
Conventional First Lien Mortgages								
American Indian or Alaska Native	917	100.0%	449	49.0%	115	12.5%	353	38.5%
Asian	2,042	100.0%	1,174	57.5%	317	15.5%	551	27.0%
African American	3,008	100.0%	1,109	36.9%	406	13.5%	1,493	49.6%
Native Hawaiian or Other Pacific Islander	481	100.0%	242	50.3%	61	12.7%	178	37.0%
Non-Hispanic White	44,126	100.0%	26,222	59.4%	6,445	14.6%	11,459	26.0%
Hispanic	3,999	100.0%	1,994	49.9%	572	14.3%	1,433	35.8%
Missing/Not Applicable	10,028	100.0%	5,562	55.5%	1,610	16.1%	2,856	28.5%
Total	63,810	100.0%	36,383	57.0%	9,429	14.8%	17,998	28.2%
Government First Lien Mortgages								
American Indian or Alaska Native	894	100.0%	633	70.8%	120	13.4%	141	15.8%
Asian	1,534	100.0%	1,128	73.5%	238	15.5%	168	11.0%
African American	5,181	100.0%	3,417	66.0%	829	16.0%	935	18.0%
Native Hawaiian or Other Pacific Islander	674	100.0%	496	73.6%	95	14.1%	83	12.3%
Non-Hispanic White	21,299	100.0%	15,805	74.2%	2,873	13.5%	2,621	12.3%
Hispanic	4,436	100.0%	3,179	71.7%	679	15.3%	578	13.0%
Missing/Not Applicable	5,870	100.0%	4,186	71.3%	908	15.5%	776	13.2%
Total	38,570	100.0%	27,925	72.4%	5,534	14.3%	5,111	13.3%
Home Equity Mortgages								
American Indian or Alaska Native	123	100.0%	41	33.3%	5	4.1%	77	62.6%
Asian	155	100.0%	68	43.9%	12	7.7%	75	48.4%
African American	474	100.0%	123	25.9%	31	6.5%	320	67.5%
Native Hawaiian or Other Pacific Islander	57	100.0%	14	24.6%	2	3.5%	41	71.9%
Non-Hispanic White	4,097	100.0%	1,798	43.9%	352	8.6%	1,947	47.5%
Hispanic	521	100.0%	185	35.5%	30	5.8%	306	58.7%
Missing/Not Applicable	2,109	100.0%	593	28.1%	152	7.2%	1,364	64.7%
Total	7,445	100.0%	2,797	37.6%	581	7.8%	4,067	54.6%

Notes:

- Withdrawn applications, files closed due to incompleteness, and applications for preapproval are excluded from the distributions.
- The sum of the counts appearing in each race/ethnicity category do not necessarily sum to the "Total" category because race/ethnicity categories are not mutually exclusive.

Underwriting Model Results

Hypothetical Lending Institution Fair Lending Analysis of HMDA Data - 2011

Selected Results from Logistic Analysis of Incidence of Denial by Applicant Race/Ethnicity

Protected Class	Model	Non-Hispanic White		Protected Class		Odds Ratio	p-Value	Pseudo R-Squared
		Total	Denials	Total	Denials			
Conventional First Lien Mortgages								
African American	Raw	44,126	11,459	3,008	1,493	2.810	0.000	0.013
	Credit Model	44,074	11,408	3,001	1,487	1.335	0.000	0.359
Hispanic	Raw	44,126	11,459	3,999	1,433	1.592	0.000	0.003
	Credit Model	44,078	11,412	3,989	1,423	1.143	0.002	0.353
Government First Lien Mortgages								
African American	Raw	21,299	2,621	5,181	935	1.570	0.000	0.005
	Credit Model	21,278	2,614	5,171	935	1.212	0.000	0.341
Hispanic	Raw	21,299	2,621	4,436	578	1.067	0.131	0.000
	Credit Model	21,278	2,615	4,431	577	1.088	0.126	0.330
Home Equity Mortgages								
African American	Raw	4,097	1,947	474	320	2.294	0.000	0.011
	Credit Model	3,789	1,650	365	212	0.900	0.555	0.560
Hispanic	Raw	4,097	1,947	521	306	1.575	0.000	0.004
	Credit Model	3,800	1,661	451	237	0.966	0.831	0.557

Hypothetical Lending Institution
Fair Lending Analysis of HMDA Data - 2011
Average APR for Originated Loans by Applicant Race/Ethnicity

Borrower Race/Ethnicity	Loan Count	Average APR
Conventional First Lien Mortgages		
American Indian or Alaska Native	449	4.62%
Asian	1,174	4.55%
African American	1,109	4.71%
Native Hawaiian or Other Pacific Islander	242	4.59%
Non-Hispanic White	26,222	4.57%
Hispanic	1,994	4.65%
Missing/Not Applicable	5,562	4.57%
Total	36,383	4.58%
Government First Lien Mortgages		
American Indian or Alaska Native	633	4.86%
Asian	1,128	4.84%
African American	3,417	4.85%
Native Hawaiian or Other Pacific Islander	496	4.85%
Non-Hispanic White	15,805	4.88%
Hispanic	3,179	4.87%
Missing/Not Applicable	4,186	4.84%
Total	27,925	4.87%
Home Equity Mortgages		
American Indian or Alaska Native	41	7.48%
Asian	68	6.92%
African American	123	7.05%
Native Hawaiian or Other Pacific Islander	14	7.11%
Non-Hispanic White	1,798	7.00%
Hispanic	185	6.91%
Missing/Not Applicable	593	7.05%
Total	2,797	7.01%

Notes:

-The sum of the counts appearing in each race/ethnicity category do not necessarily sum to the "Total" category because race/ethnicity categories are not mutually exclusive.

Pricing (APR) Model Results

Hypothetical Lending Institution Fair Lending Analysis of HMDA Data - 2011

Selected Results from Regression Analysis of Level of APR by Borrower Race/Ethnicity

Protected Class	Model	Non-Hispanic White Loan Count	Protected Class Loan Count	Coefficient (Basis Points)	p-Value	Adjusted R-Squared
Conventional First Lien Mortgages						
African American	Raw	26,222	1,109	13.62	0.000	0.003
	Credit Model	26,222	1,109	3.32	0.000	0.765
Hispanic	Raw	26,222	1,994	7.97	0.000	0.001
	Credit Model	26,222	1,994	1.27	0.016	0.767
Government First Lien Mortgages						
African American	Raw	15,805	3,417	-3.05	0.000	0.001
	Credit Model	15,805	3,417	-1.32	0.000	0.643
Hispanic	Raw	15,805	3,179	-1.39	0.007	0.000
	Credit Model	15,805	3,179	-1.02	0.001	0.647
Home Equity Mortgages						
African American	Raw	1,798	123	5.69	0.610	0.000
	Credit Model	1,798	123	0.51	0.935	0.814
Hispanic	Raw	1,798	185	-8.43	0.377	0.000
	Credit Model	1,798	185	0.53	0.923	0.801

Focus on Redlining

“Redlining is 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.”

Interagency Fair Lending Examination Procedures – August 2009

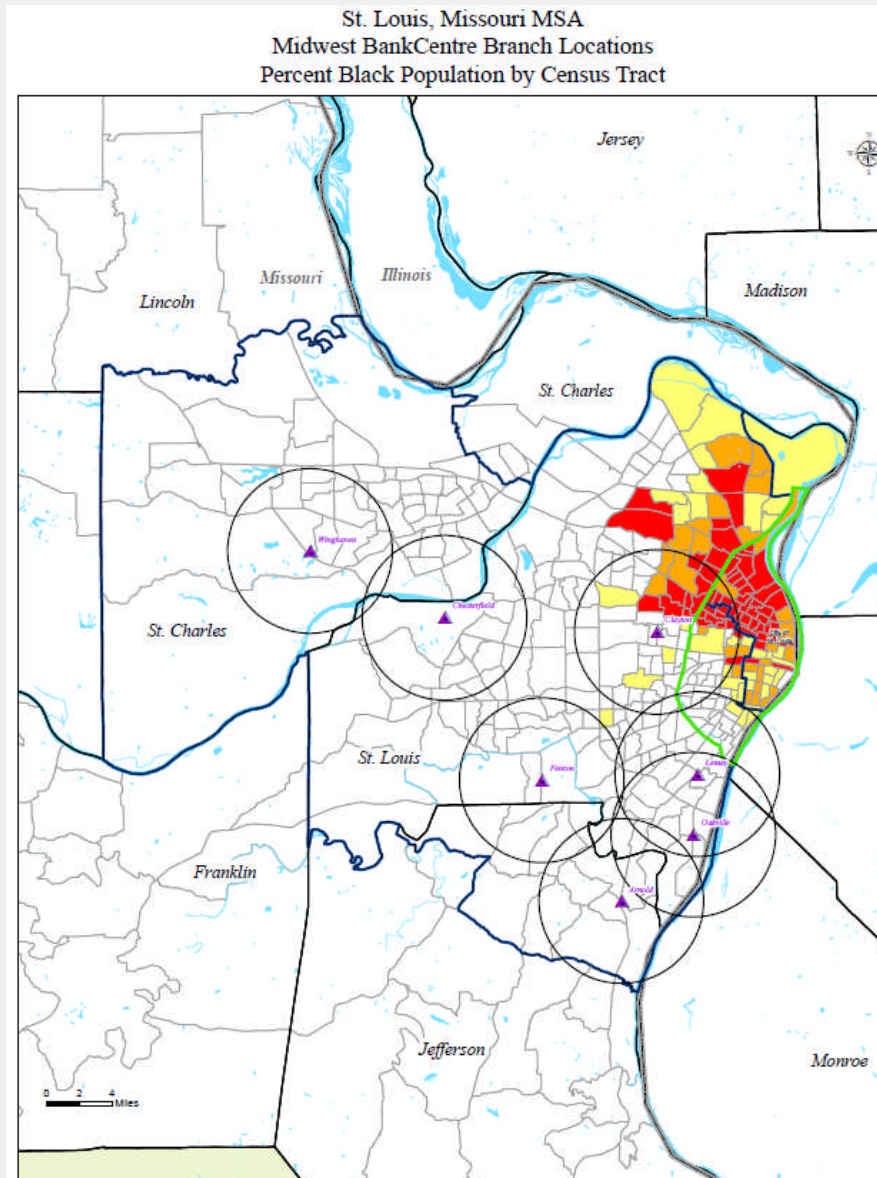
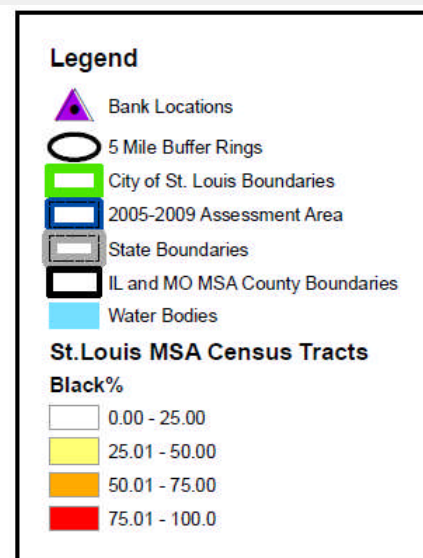
Focus on Redlining (cont.)

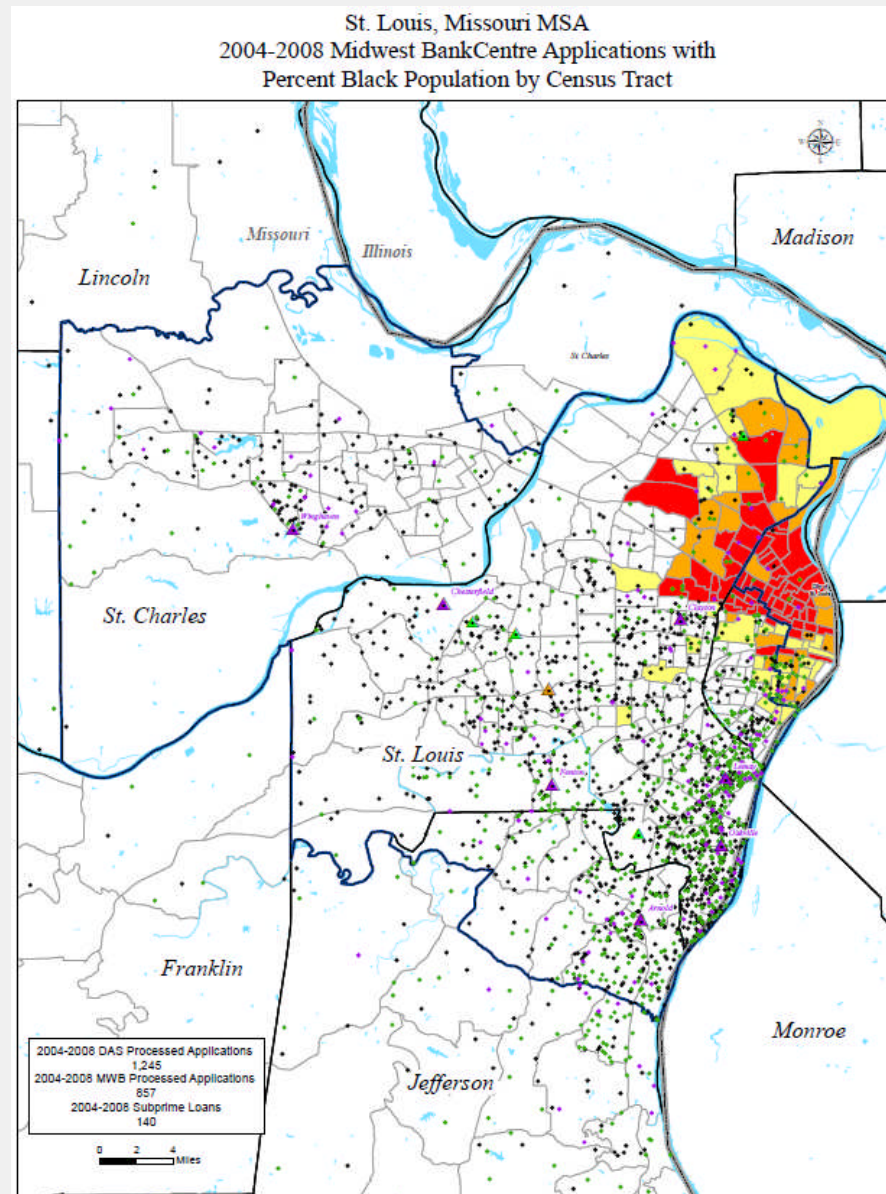
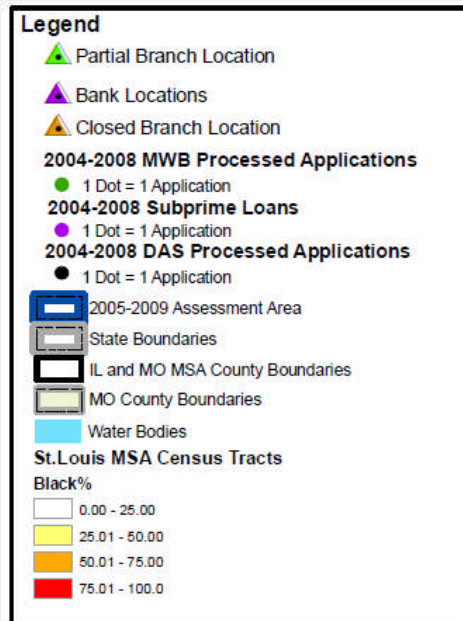
- **Investigating Redlining**

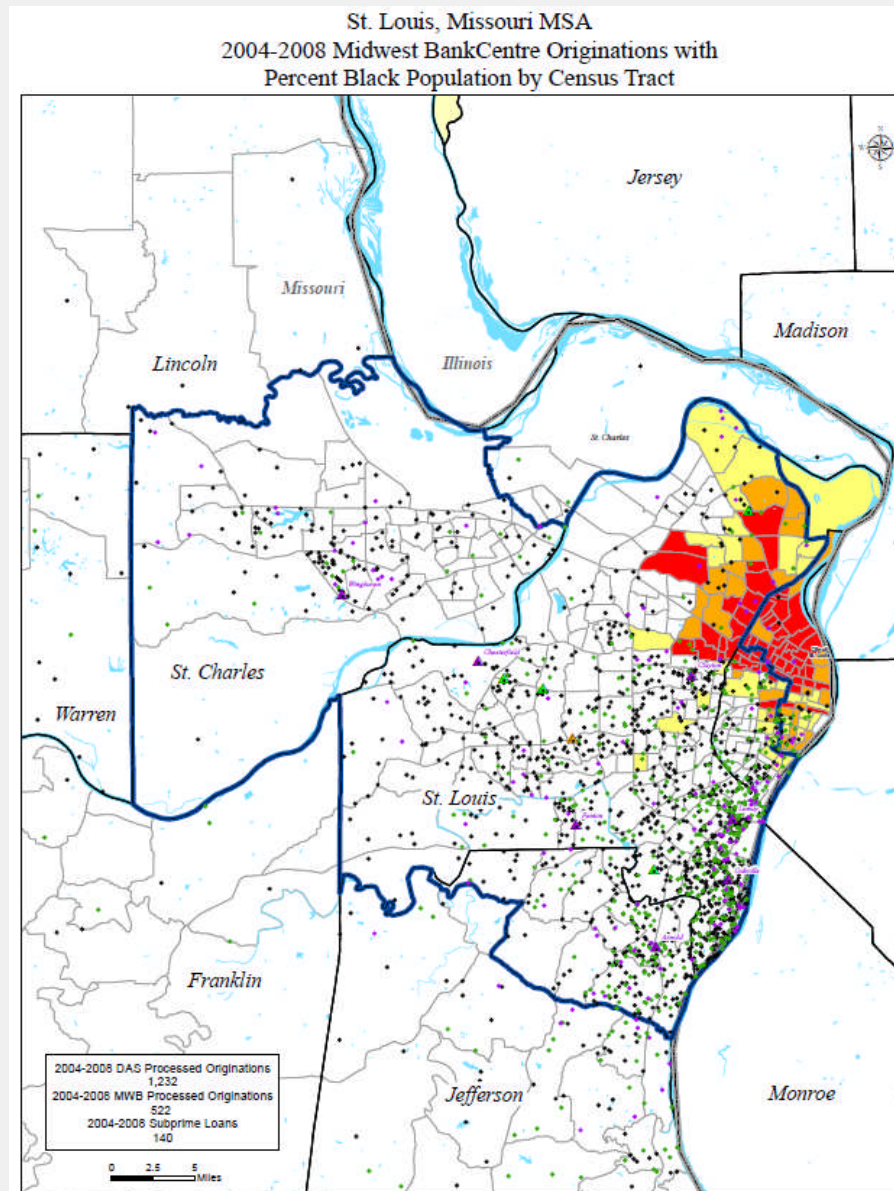
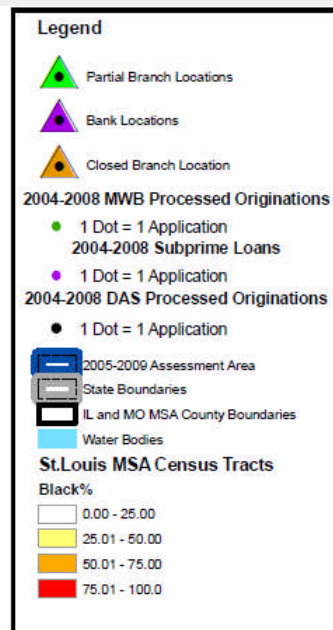
- Evaluation of the geographic areas included in the institution's "CRA Assessment Area" and "Market Area"
- Review of the lender's business practices, including branch locations, lending policies, and marketing activities
- Comparison of application and origination volumes of the lender in mostly or predominately minority areas with those of similar institutions operating in the same areas

- **Recent Cases**

- *United States v. Citizens Republic Bancorp, Inc.*
- *United States v. Midwest BankCentre*







Impact of the Dodd-Frank Act

■ The CFPB

- Has rulemaking authority with respect to the federal consumer financial laws, including ECOA
- Has examination and enforcement authority over
 - insured depository institutions with assets in excess of \$10 billion and their affiliates
 - certain nonbank entities, including mortgage loan brokers and servicers
- Like the federal banking agencies, it is required by ECOA to refer cases involving a “pattern or practice” of discriminatory lending to DOJ

Requests for Privileged Information by the CFPB

- 12 U.S.C. §1828(x) - privileges not affected by disclosure to banking agency or supervisor
 - The submission by any person of any information to any Federal banking agency, State bank supervisor, or foreign banking authority for any purpose in the course of any supervisory or regulatory process of such agency, supervisor, or authority shall not be construed as waiving, destroying, or otherwise affecting any privilege such person may claim with respect to such information under Federal or State law as to any person or entity other than such agency, supervisor, or authority.
- Section 363 of the Dodd-Frank Act amended 12 U.S.C. § 1813(z) to remove the OTS from the definition of a “Federal banking agency”
- Significantly, it was not amended to include the CFPB within the scope of that definition
- Unless and until legislation is passed to correct the situation, an institution that produces privileged material to the CFPB could face a claim that it has waived privilege

CFPB Definitions

- Definition of “fair lending”
 - The Dodd-Frank Act defines “fair lending” to mean “fair, equitable, and nondiscriminatory access to credit for consumers”
 - It remains to be seen how this standard will be applied
- Unfair – causes or is likely to cause substantial injury to consumers; not reasonably avoidable; and injury not outweighed by offsetting benefits (e.g. lower prices, more products). Substantial injury involves monetary harm (e.g. costs or fees – even small amount if large number of consumers impacted)
- Deceptive – misleads or is likely to mislead in a material way (central characteristics; expressed claims ...); consumer’s interpretation is reasonable (e.g. bait & switch). Evaluation with the four P’s (prominence, presented in easy to understand format; placement where consumers look; info in close proximity to claim) – and may be interpreted relative to a particular target audience

UDAAP and Fair Lending Cases

- Definition of “Abusive” in New UDAAP Standard
 - An act or practice may be abusive if it:
 - “materially interferes with the ability of a consumer to understand a term or condition of a financial product or service; or
 - take unreasonable advantage of —
 - a lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
 - the inability of the consumer to protect the interests of the consumer in selecting or using a financial product or service; or
 - the reasonable reliance of the consumer on a covered person to act in the interests of the consumer.”
- UDAAP cases often morph into fair lending cases
- Members of protected classes in a UDAAP case could be disproportionately affected

Identification

- Analysis of Complaints to Institution
 - Repeated complaints about same issue
 - Substantive complaints
 - High volume of charge backs or refunds
- Analysis of Other Complaints
 - Subsidiaries, affiliates, third parties regarding products offered through the institution or using the institution's name

Examination Objectives

- Assess quality of compliance risk management – review of internal controls and policies and procedures
 - Doc review:
 - lists of products, descriptions, fees, disclosures, account statements
 - Procedure manuals and written policies
 - Management and Board meeting minutes
 - Internal control and monitoring information
 - Compensation
 - Scripts, marketing, promotional materials
 - Third party agreements
- Identify acts or practices that materially increase risk of UDAAP violations
- Gather facts
- Determine violations, in consultation with agency headquarters

Transaction Testing High Risk Areas Identified

- Are products underwritten on basis of ability to repay?
- Does product profitability depend on penalty fees or back-end rather than upfront fees?
- Does product have high rates of repricing or changes in terms?
- Does combination of terms increase difficulty in understanding?
- Are there penalties for terminating relationship?
- Does consumer bear fees or costs to get information about own accounts?
- Is product targeted to particular populations without making sure marketing / disclosures suit that population?

Transaction-Related Exam Procedures

- Marketing and Disclosures
 - Facts are clear; prominent; costs as represented
- Availability of Terms or Services as Advertised
 - Choose sufficient sample (different channels, geographies, sectors)
 - Include approved/denied
 - Determine acceptance rates
 - Determine specific product
 - Determine counteroffers
- Availability of Actual Credit (sufficient with typical fees, charges)
- Employees and Third Parties (no unintended incentives, monitoring)
- Services and Collections

Focus

- Products
- Fees
- Costs v. Benefits
- Offered v. Actual
- Tradeoff between consumer benefit and bank profitability

Going Forward—Challenges and Issues

- The CFPB and “Compliance Management Systems” (“CMSs”)
 - A bank-like safety and soundness approach
 - Non-bank management and boards of directors are uncomfortable with CMSs as a requirement
 - Not supported by state corporate law obligations
 - Being imposed by formal or informal enforcement orders by the CFPB

Going Forward—Challenges and Issues

- The Records Retention Conundrum
 - CFPB Mortgage Initiative may ultimately require lenders to link all loan origination data to loan servicing platforms
 - TILA back-end penalties created by the Dodd-Frank Act may require permanent retention of origination data

Going Forward—Challenges and Issues

- The CFPB Agenda for the near future—
 - Expanded HMDA data
 - ECOA small business data gathering
 - Possible fair lending expansion into a wide range of non-mortgage products
 - Use of CFPB enforcement attorneys at examinations focusing on fair lending

Going Forward—Challenges and Issues

- Lenders should understand appeals process
 - During an exam—the Ombudsman
 - Following an exam—the CFPB recently announced appeals process
 - Upon the issuance of an enforcement order—an administrative hearing (good luck with that...)

Discussion Questions

- How to assess products? Qualitative? Quantitative?
- How systematic is assessment of products already in place?
- How much research is done before introduction of new product?
- How are populations targeted?
 - Exclusive products? Exclusive terms?
- Are complaints tracked and monitored? By whom?
- What is feedback among operational units in bank?
 - Interaction between business lines and compliance staff
- Not equivalent to disparate treatment! Similar treatment and similar impact may exist simultaneously with unfair, deceptive, or abusive acts or practices

Questions?

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