

Federal Fair Lending Regulations and Statutes

Alternative Examination Approach for Low-Risk Banks

The alternative approach to fair lending examinations is designed for banks found during the fair lending scoping process to be at low risk of discriminatory practices. These low-risk banks typically are stable community banks located in suburban or rural areas that have a very low proportion of minority residents; they often are predominantly commercial or agricultural lenders that offer standard loan products and may lack sufficient prohibited-basis denials to conduct an underwriting analysis. These banks also tend to have stable staffing, no significant changes in bank policy and procedures since the most recent examination, and no history of fair lending concerns.

Use of this alternative examination approach should help validate the conclusions reached during the scoping process and should reduce the number of resources devoted to examinations of banks whose risk level clearly is not high enough to warrant extensive comparative analysis.

Successful use of this alternative examination approach depends on the integrity of the scoping process. As a result, it is important that all relevant areas of credit operations, including commercial and agricultural lending, are considered during the scoping process. If no risk factors are identified during scoping, examiners should proceed with the following steps:

1. Select a judgmental sample of loans for review to test how the lending criteria are actually applied. The sample should be representative of the major product lines of the institution and should include denials as well as approvals that were processed in the preceding twelve months.
2. Review the transactions to determine if they were underwritten according to the bank's articulated lending criteria. The transactions should not, therefore, be compared with each other, as they are in a benchmark or overlap analysis. Deviations in underwriting should be investigated and documented. This review will

verify actual underwriting practices and may result in the identification of risk factors.

3. Use the same sample to review the bank's pricing practices (it may be necessary to add a few more approvals to take the place of the denials in the original sample). Loan pricing should be compared with the bank's pricing methodology that was described to examiners during the scoping process. The transactions should not be compared with each other, as is the practice for the terms-and-conditions analysis. Pricing deviations should be investigated and documented. This review will verify actual pricing practices and may result in the identification of risk factors.
4. If no risk factors are identified using these alternative procedures, then the low-risk conclusion drawn in the scoping process is validated. At this point, the discrimination analysis is complete.
5. If risk factors are identified through either the underwriting or the pricing review, a focal point should be established and the sample expanded for that particular product line to do a full analysis using either a benchmark or overlap analysis or the terms-and-conditions examination procedures. Sample sizes should correspond to those in the sample size tables in the appendix to the examination procedures and should be focused on marginal applicants.
6. The fair lending scoping for the next examination should not assume that the bank remains low-risk. The scoping process should make a new determination of the risk level of the bank.

The fair lending scope memo should document the reasons the bank was determined to be low-risk. The fair lending section of the Report of Examination should state that the alternative examination approach was used because the bank exhibited low discrimination risk. Any appropriate comments about the bank's underwriting or pricing practices should be included.